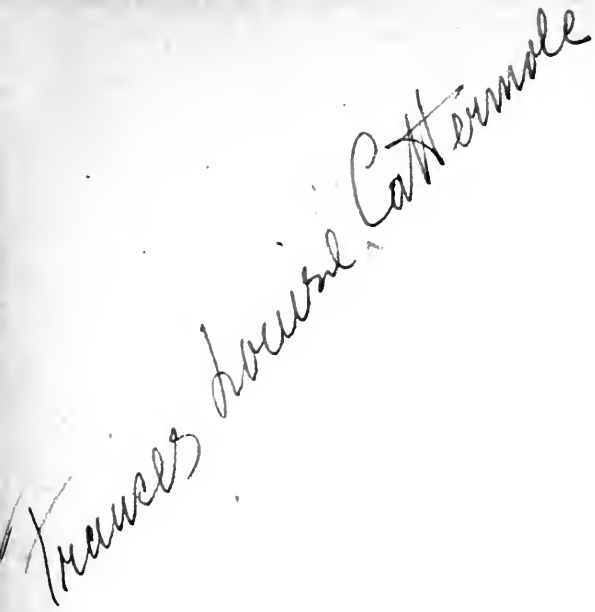
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VOLUME V

THE LAW OF PRIVATE BUSINESS CORPORATIONS

WITH

QUESTIONS, PROBLEMS AND FORMS

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PREFACE TO THIS VOLUME.

An attempt has been made in this volume to set out the general law which governs incorporated companies and to give a few practical suggestions concerning their organization and management. But the layman should bear in mind that the law of corporations is to a considerable extent a matter of local statute, and that such statutes are often modified or changed. If a corporation is formed, or if change is sought in an existing corporation, or if any matter of moment arises, it is better to consult an attorney of ability and known carefulness. The records of any corporation should be full and complete, its books carefully kept, its reports to state officers faithfully and promptly made. This book endeavors to show the nature of the corporation, the nature of its charter and by-laws, the purpose and extent of its corporate meetings and the minutes thereof, the powers and duties of its directors and executive officers, and all matters of a fundamental nature that apply to all corporations wherever incorporated.

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THE LAW OF PRIVATE BUSINESS CORPORATIONS.

PART I.

CREATION AND ORGANIZATION OF CORPORATIONS.

CHAPTER 1.

DEFINITION AND GENERAL EXPLANATION.

Sec. 1. DEFINITION. A private business corporation is an artificial person, created and existing under and by virtue of the franchise of the state.

For the encouragement and convenience of trade and commerce the law deems it expedient to permit the organization of a business in such a way that it shall constitute a legal entity distinct and separate, as such, from those who have established and who conduct it. It is considered that it should be possible for parties to have a commercial enterprise that shall be a thing apart from its real owners so that those who deal with it must look to it alone and be bound to it alone for the performance of all obligations; that as an organization it should have power to hold legal title to property, to enter into contracts, to sue and be sued, and that those responsible for it as an enterprise, should not be responsible upon its contracts or for its debts.

To bring this about, the state grants a franchise or charter permitting men to organize a business having an identity distinct from those who organize or own it. Unless this franchise or charter is obtained, that which a person does in a business way is that which *he* does as a person. The liability is personal, the contracts made, whether by him in person, or by agents for him, are *his* contracts, and though such man by his system of keeping books regards that business as utterly distinct from his home or other personal affairs, and distinct from what other business affairs he may have, yet in the law no such distinction can be made. If suit is brought, *he* is sued; if property is purchased, *he* owns it; if the business goes into bankruptcy, *he* goes into bankruptcy. And what is true of him if he is in business by himself is also true of him if he is in business with others as partners. But if this charter from the state is secured the business may be made a thing apart, as above explained.

Chief Justice Marshall, in a definition which has become famous, described a corporation as "an artificial being, intangible, invisible, and existing only in contemplation of law."[1] This definition has been criticised, and yet, so long as the corporation is organized and conducted for legitimate business purposes, it is correct, for a corporation is indeed "an artificial person" which exists "only in contemplation of law." It is more than an association of individuals. In legal theory, it is an entity, and as such, possesses many of the attributes of a natural person; and it

1. Dartmouth College v. Woodward, 4 Wheat. (U. S.) 518, 636.

stands apart from all other members of the community, including its own shareholders, and is for proper purposes as distinct from them as they are from each other. It may contract with them, buy from and sell to them, sue them and be sued by them. The act of the corporation is not the act of its shareholders; its liability is not their liability; its assets do not belong to them. But the corporation, as such, may, like a natural person, acquire, hold and grant property, commit torts and crimes, sue and be sued.

This separate, well defined existence of the corporation is a legal fiction permitted for the legitimate purposes of trade and commerce. A number of men are seen working together; they are using a name arbitrarily chosen by them for their common designation in tradal association; and yet they say that it is not their name, but the name of an "artificial person," for whom they are working, with whom they have a contract, from whom some of them draw salaries or whose profits they take and divide among them. Where is this individual, of whose identity they are so sure? It does not think, will, speak, act, except through them; and yet it has an existence that stands apart, limited and certain.

It is because the state gives sanction that this child of the imagination can come forth and be a substantial member of the business community. Its legal standing is derived from political *fiat;* and this *fiat* we find expressed in the corporate charter. Without a charter, that is to say, without the franchise of the state, there cannot be a corporation.

This legal, separate existence is permitted for the convenience and the encouragement of commerce. The fiction may not be made a shield for illegal action. While the members of a corporation are not responsible for its torts which they do not sanction, or its crimes which they have no part in, yet if they organize it in order to shield themselves in fraudulent or other illegal devices, hoping by this legal fiction to escape legal responsibility, the courts will seek out the real offenders and fix the responsibility and visit the punishment upon them.

Sec. 2. CORPORATIONS DISTINGUISHED FROM PARTNERSHIPS. A partnership is not a legal entity but a relationship growing out of a contract by individuals to conduct a business enterprise as the co-owners thereof, sharing the profits and losses.

A partnership is a combination of persons whose rights and liabilities are governed by a contract whereby they have agreed to mutually conduct a business as the co-owners thereof, sharing the profits and losses.[2] No separate individuality in the law is thereby created. A relationship, not an entity, has been established. The acts of the partnership are the acts of its members; its liability is their liability. Also, the partnership has no charter from the state; it arises by mere agreement between the parties.

If under such an arrangement corporation organization is copied and the capital stock is made a fixed amount and divided into transferable shares which are represented by certificates issued to the owners

2. See "The Law of Partnership" in this Series.

thereof, the concern is known as a joint stock company. Such a concern, having no charter from the state, is still a partnership in all of its substantial legal aspects, and the liability arising is the liability of the members, and although in some few states statutes have been passed limiting the liability of members of such a concern provided there is publication, recording, etc., of various papers, yet organization in this form is not common inasmuch as it lacks the separate legal existence usually regarded as the chief *desideratum*.

Sec. 3. REASONS FOR THE INCORPORATION OF BUSINESS COMPANIES. The main reasons for the incorporation of companies are to secure limitation of personal liability, to effect a more permanent and systematic organization, and in cases, to secure funds or a better credit.

We may now consider those chief considerations which induce men to incorporate a business. We will notice in a later section[3] that it may not always be desirable to incorporate, yet in a great many cases, especially in large businesses, the considerations in favor of incorporation outweigh those which are against it. Amplifying the black letter text, we may set forth a number of distinct considerations which lead parties to secure a charter.

(1) The liability of shareholders is limited to the amount of their subscriptions.

This indeed is the great reason, it may be assumed, why incorporation is desirable. For, under the laws of the various states, with very few and

3. Section 15, *post*.

narrow exceptions, the par value of the stock for which one subscribes represents the total amount that he may be called upon to pay either by the corporation or creditors of the corporation. When he has once paid that amount, his liability is gone; no further sum may be called for, no assessments may be voted against him, though all the other shareholders should join in the vote.[3a]

In a partnership, one's liability to creditors is personal and unlimited. Perhaps by agreement the other partners have no right to call for more than a certain amount, but this does not affect creditors, who may out of the assets of any single partner collect their judgments, leaving such partner to reimbursement by his associates for their share of the debt, who, being absent or becoming insolvent, may not be responsible. If one deals with the firm of A, B, & C, he may know that his claims are collectible so long as any member of that firm remains solvent.

(2) The members of a corporation are not liable for the unauthorized acts of their associates.

There is a rule in the law of agency that a principal is not only responsible for the acts and contracts which he really authorized but for those also which he *seems* to have authorized. He will be made liable for all acts done and contracts made within the scope of the agent's *apparent* authority.

An agent has apparent authority to do all those things which one would reasonably expect an agent to have authority to do from the position in which

3a. In California and one or two other states fully paid capital stock may be assessed.

the principal has placed him. A special agent has very limited authority, but an agent whose authority is of a general nature may be expected to have all the authority that is reasonably necessary to carry on the work which he is in charge of—such authority as persons in that situation usually have.

Consequently principals are often bound upon contracts made by agents which are entered into by the agent without any real authority or, perhaps, even against express instructions. If the agent *seems* from his position—the position in which the principal has placed him—to have authority, a third person is justified in believing that he has such authority.

Now it is true that this rule applies in its full force in respect to corporations, and the corporation may be bound by the acts of a general agent which are not within his real authority, but it is the *corporation* which is bound and not the shareholders. Now if one is conducting a business which is not incorporated he is conducting it as a partner or as sole owner. If he is in a partnership, each of his partners is a general agent of the others and as such, has a large apparent authority, and thus may bind the others upon acts which their own discretion would have forbidden. And if one is not a partner in a business, but the sole owner thereof, still he may have agents and servants to help him conduct it. But shareholders in a corporation are neither agents of the corporation nor of the other shareholders, and consequently neither the corporation nor the shareholders are responsible for the acts and contracts attempted to be made by the other shareholders as agents of the corporation unless there has been some special appointment whereby such shareholders became also agents.

It is likewise a law of agency that a principal is responsible for the *torts* of his agent or servant committed within the scope of the authority and this rule makes one whose business is unincorporated responsible for negligence, fraud and other torts of his agents and servants, and of his partners, if he have partners.

The incorporation of a company creates a new person who shall stand as the principal upon the contracts made in its name by its agents and for the torts of its agents and servants; and incorporation thus serves to limit liability in this respect.

(3) The corporate form affords stability and permanency of organization.

The death of the owner of a business, or of one of the partners in a business, necessitates a reorganization if the business is to continue. And where a business is owned by several as partners, none of them has any right to transfer his interest without the consent of all the others and such transfer without consent results in dissolution. But corporate shares are freely transferable, and the sale of shares or the death of a shareholder does not in any sense affect the existence of the corporation.

(4) Incorporation encourages systematic organization.

It can readily be seen that the incorporation of a company means in itself, almost necessarily, a systematic organization. The very permanency of the corporate life encourages the introduction and main-

tenance of system. Officers are to be elected, the authority of each one of them is to be determined, by-laws are to be adopted, shares are to be issued, and all of this encourages systematic organization.

(5) The incorporation of a company often furnishes better facilities for raising capital and borrowing money.

Many a person will become a subscriber to shares of stock who would not in that particular business take upon himself the more onerous liability of a partner. Corporate shares may therefore be sold where shares in the same business unincorporated would go begging. This is a matter of every day observation. And capital may be secured also by the issuance of *preferred shares*, defined and described later in the text, which give the holder a certain assurance of return of a certain amount. So the corporate form becomes a necessity if the borrowing of money is to be accomplished through a bond issue, which may be widely distributed and yet every bondholder have his security in the same trust deed or mortgage upon the property of the borrower.

(6) A corporation furnishes a legal unity for purposes of suit, holding title, making contracts, etc.

This is a matter of great convenience especially where the corporation is of any considerable size or has many interested in it.

SEC. 4. GENERAL POWER OF CORPORATIONS TO CONTRACT AND TO COMMIT TORTS AND CRIMES. A corporation may enter into all contracts which fairly tend to accomplish its corporate purposes, and such contracts bind the corporation the same as contracts made by natural persons bind them; but it has no power to make other contracts. A corporation has the power to commit torts and crimes.

We will hereafter consider in detail to what extent a corporation may enter into contracts and the results which follow where it attempts to make contracts which it has no right to make, and so at this point for the purpose of our better understanding of the nature of a corporation may simply note that a corporation is a competent party to any contract made for the purpose of carrying out its charter powers, and these contracts are binding upon it as a legal entity in the same manner as contracts are binding upon natural persons, and they are not binding upon the officers who make the contract for the corporation, or upon the shareholders for whose ultimate benefit the contract is made. This follows from, as it is the purpose of, the theory of the separate existence of the corporation as an entity.

A corporation has only those powers which are expressly or impliedly given to it in its charter. Its power to enter into contract is governed by the terms of its charter. A natural person can make any contract so long as it is not illegal or against public policy. But a corporation can only make those contracts which fairly tend to contribute to the carrying on of the business which it is authorized to do by its charter.

A corporation has the power to commit torts and may be sued for the damages thereby caused. For illustration, corporations may be guilty of defamation, conspiracy, conversion of another's property, negligence; and so on.

Of course the corporation is not responsible for those torts of its agents and servants which are committed by them independently of their employment, or, as it is said, not within the scope of their authority or employment. A corporation is answerable for those torts committed by its agents and servants which any other principal would be responsible for. In other words, the general law of agency governs this subject and a corporation is liable for the acts of its representatives under the same rules that would govern the responsibility of any other principal.

A corporation may likewise be guilty of crimes and be punished by way of fine. It may, for instance, violate speed ordinances, adulterate foods, enter into criminal conspiracies, give illegal rebates, etc.

Sec. 5. KINDS OF CORPORATIONS. Corporations may be divided into public or municipal corporations and private corporations. The latter may again be divided into stock and non-stock corporations.

We may classify corporations as follows:

(1) Public corporations, or such as are founded by the government for public purposes.
   - A. Municipal, as cities and towns.
   - B. Quasi municipal, as counties, school districts, etc.

(2) Private corporations, or corporations owned by private individuals, although perhaps of a public nature.

A. Stock corporations, organized for purposes of financial profit. Railroads, street railways and the like are private corporations, though sometimes called public or quasi public. Under this heading fall all companies organized for profit.

B. Non-stock corporations organized for purposes of charity, learning, pleasure, mutual assistance, etc.

We see by the above tabulation that the theory of corporate organization is made use of for many purposes quite dissimilar. We shall find opportunity in the present text to discuss only private business corporations.

Sec. 6. PURPOSES FOR WHICH CORPORATIONS MAY BE FORMED. A corporation may be formed for almost any legitimate purpose. But it may in any state be against the policy of the law to permit corporations to engage in certain activities which may be carried on by individuals and unincorporated companies.

It is a usual provision of the corporation laws in the various states that companies may be incorporated to carry on any lawful business. And generally it may be said, that whatever may be done in a business way by natural persons may also be done by the artificial person or corporation. But there must be some exceptions made to this state-

ment. It is against the policy of the laws of some states to permit corporations to engage in certain activities. For instance, under the laws of the state of Illinois, a corporation may not be organized for the main purpose of dealing in real estate (although, of course, when formed for other purposes it may own all the real estate reasonably necessary or convenient for its corporate purposes). It is also declared to be against the policy of that state to permit corporations to own shares in other corporations for the purpose of controlling such other corporations. A recent decision in the state of New York is to the effect that corporations cannot be organized in that state for the purpose of engaging in the practice of the law.[4]

Eliminating the few and narrow exceptions which the policy of the state may create, we may state the general rule to be that corporations may be formed to carry on any line of legitimate business.

4. Re Co-operative Law Co., 198 N. Y. 479.

CHAPTER 2.

OF THE CORPORATE CHARTER.

Sec. 7. NECESSITY AND GENERAL NATURE OF CHARTER. A charter is necessary to corporate existence; the terms of that charter determine the scope of the corporate existence.

We have already noticed that a corporation exists by virtue of the grant and permission of the state, as expressed in the charter and otherwise cannot exist. And just as the charter is the evidence of the right to exist, so it is, by the same token, the evidence of the scope or breadth of the corporate existence. We must look to the charter to discover the powers of the corporation.

The subject of the powers of the corporation is taken up hereafter. Therefore we need only to notice at this point in a general way that a corporation has those powers which are expressly granted to it in its charter, and furthermore, all powers which by reasonable inference are necessary in order to carry its expressly granted powers into execution; and it has no further powers than these.

In drafting the charter great care should be taken in the statement of the powers or objects of the corporation, so that it may not be hampered in its activities; yet it is not necessary, and indeed it is not usual or good practice, to set out those powers which arise by clear implication. Thus, it need not be

stated that the corporation shall have power to own a plant by which to conduct its business, that it shall have power to enter into contracts, to buy and sell, to borrow money, to employ clerks, give notes, etc.

A statement of the objects of a corporation as they may be set forth in the charter is given in the appendix by way of illustration.

The usual charter provisions are in respect to (1) the name; (2) the objects of the corporation; (3) the amount of capital stock; (4) the number and amount of shares; (5) the duration of life; (6) the location of the principal office.

Sec. 8. POWER OF THE STATE AND FEDERAL GOVERNMENTS TO GRANT CHARTERS. The general power to incorporate companies is retained by the states. The federal government, however, has power to grant charters when it may thereby reasonably accomplish some end in the performance of the powers expressly granted in the constitution.

Our federal government is a government whose powers are said to consist in a *grant*. The federal constitution is the expression of that grant. Whatever power is not thereby granted is retained by the states. Whenever we desire to know whether the federal government has a certain power, we must look to the federal constitution to see whether that power has been given. Yet it is a well-known rule of construction applicable to the federal constitution that all powers are thereby given which are by reasonable inference necessary to carry the expressly given powers into execution. These are the implied powers. Just as a state in granting a corporate charter grants some powers by implication, so the states,

in granting power to the federal government, gave therewith all those powers which by reasonable and fair implication are necessary to a proper and unhampered exercise of the powers expressly granted. The federal constitution says nothing in reference to the power to grant charters to corporations. Accordingly we may at once conclude that the federal government has no power to grant charters as one of its functions. It cannot incorporate companies with that end alone in view. Yet it has been decided that where it may make use of an incorporated company as a vehicle reasonably adapted to carry its express powers into execution, it may create such corporations for that purpose. Thus in order to carry out its extensive fiscal powers, it may charter a National Bank.[5]

Sec. 9. POWER OF STATE TO ALTER AND REPEAL CHARTERS. The charter is a contract, and cannot be repealed or altered by the state except upon a reservation of that right by the state at the time it grants the charter.

It was early decided, in the famous case of Dartmouth College vs. Woodward,[6] by the United States Supreme Court, that a charter granted by the state is a contract by the state with the incorporators and their successors. The federal constitution provides that no state shall pass any law impairing the obligation of contracts, and this provision, as decided

5. McCulloch v. Maryland, 4 Wheat. 316. So it has been held that under the interstate commerce powers, Congress may incorporate a railroad. California v. P. R. R., 127 U. S. 4.
6. 4 Wheat. (U. S.) 518.

in the case mentioned, prevents the state from altering or repealing a charter without the consent of all concerned unless the right to alter or repeal was reserved beforehand.

This decision was followed by the enactment of constitutional provisions and statutes in all of the states that whenever a charter should be thereafter granted it should be granted subject to a right reserved by the state to alter, amend, or repeal such charter at pleasure. By this means the states early overcame the effect of that decision in respect to corporations thereafter to be formed, and the vast majority of corporations now existing hold their charters subject to a provision of that sort and the states may change their general corporation laws at any time to affect not only future corporations but also all those existing ones which have secured their charters after the enactment of these general reservations of power.

Sec. 10. FORM OF CHARTER—SPECIAL STATUTE. The early mode of incorporation was by the enactment of a private statute, passed at the instance of those who desired a charter. This special law constituted the charter.

In earlier times, by a method now obsolete, when incorporation was desired, application was made to the legislature by the incorporators for the enactment of a special law creating the corporation. Such special law constituted the charter, and there are many corporations in existence today which have such a charter. Such charters cannot be amended or taken away, if secured prior to the enactment of the general laws mentioned in section 9.

Sec. 11. FORM OF CHARTER—CERTIFICATE OR STATEMENT UNDER THE GENERAL CORPORATION LAW. The constitutions and statutes of the various states require the incorporation of commercial companies under general corporation laws applicable alike to all similarly situated. The certificate or statement made or procured under such a law together with all of the provisions of the general law applicable thereto, constitutes the charter.

Constitutional provisions and statutes of the various states now quite generally forbid the incorporation of companies by special legislation. In all of the states general corporation laws are in force which provide that corporations may be created by compliance with certain requirements. Usually it is required that a statement or certificate shall be made and recorded with certain officers, as for instance, the secretary of state, or the county recorder, or both, which shall set forth the name, objects, capitalalization and various other details of the proposed corporation.

To be exact, the charter of a company organized under present laws consists in this certificate, in which may be supposed to be embodied all of the general laws of the state which govern the particular corporation. Thus for example if a corporation in the state of Illinois is formed by filing the proper papers and receiving the certificate which shows compliance, the general law of the state which forbids corporations holding shares in other corporations for the purpose of controlling such other corporations, becomes a part of the charter, as much as though written therein.

Also, whatever in the proceeding to incorporate is contrary to the general law, is void. Thus, in Illinois, for example, if the statement of incorporation states that the object of the incorporation is to deal in real estate, such statement is nugatory, because contrary to the law in Illinois which forbids corporations to be organized for that purpose; though the secretary of state makes no objection and issues a Certificate of Complete Organization. The state laws classify corporations into several classes. There is, first, the general business corporation law under which corporations engaged in usual business activities must be incorporated. There are other general laws, applying to railroad corporations, surety companies, banks, insurance companies. These classes of corporations have peculiarities which make it advisable for particular statutes to apply to them. In all these cases however a general law governs, under which application for a charter must be made and under which the corporation must conduct its business.

Sec. 12. INCOMPLETE AND DEFECTIVE CHARTER. If the organization is defective, that is, not legally complete, it still may have progressed to an extent sufficient to give the company legal standing as a corporate body for the purpose of transacting business and incurring liabilities.

It would give rise to great confusion and accomplish much more harm than good if it could be said that every defect or incompleteness of organization or failure to comply with every law governing the regular standing of corporations should defeat corporate existence. The law is, that if there is a

statute under which incorporation can be had, and an attempt to incorporate thereunder, and actual use of the charter, there is a corporation for all practical purposes. The corporation is said then to be *de facto*. If its legal organization is perfect it is said to be a corporation *de jure*. To make a corporation *de facto* there must be *at least the three things mentioned*, the law under which a company of the kind as the one in question could have been incorporated, a *bona fide* attempt to incorporate under that law, and *user*. If such has been the case, the corporation may sue and be sued as such, make contracts, hold titles and act in all respects for business purposes as though fully organized. And those who compose it are no more liable for its debts than if it were *de jure*. Consequently if parties are sued, and reply that they are not personally liable because acting as a corporation, it is sufficient for them to prove the *de facto* existence of the corporation. And if a corporation sues and the answer is made that it is not a corporation, it is sufficient if it reply that it is a corporation *de facto*.

So long, however, as the corporation is not *de jure*, it may be attacked by the *state* in a suit to dissolve it for non-compliance with the law, or to compel its compliance.

One must bear in mind, however, that in no case nor for any purpose can a corporation exist except upon a bona fide attempt to comply with the corporation law, and a substantial compliance therewith. Merely to act as a corporation cannot constitute a corporation.

Sec. 13. AMENDMENT OF CHARTER. The corporation laws permit the members of a corporation to secure amendments to the charter by complying with their provisions in that respect.

The law permits the amendment of the corporate charter and sets out how such amendment may be brought about. Thus, the name, the amount of capitalization, the objects, may all be changed by proper procedure. These changes must all be recorded substantially as the original charter so that there may be notice of them by all concerned. Application for such change must be made usually to the same officer as application for an original charter, and certain fees paid to the state.

Of course the amendment must be secured under the laws of the same state which granted the charter.

We are not now concerned with the right of minority stockholders to resist such changes. That is considered later.

When the charter of a corporation is amended to increase its capital stock, the present shareholders are entitled to share pro rata, if they desire, in the increase.

CHAPTER 3.

OF THE FORMATION OF THE CORPORATION.

Sec. 14. IN GENERAL OF THE SUBJECT-MATTER OF THIS CHAPTER. This chapter discusses certain points in respect to the formation of a corporation, but leaves certain other points in respect thereto for more appropriate treatment at other points throughout the text.

In this chapter we will take up a number of points in respect to the formation of a corporation, but will leave certain points that might appropriately be discussed here to later treatment, as for instance, the subscription to stock to a separate chapter in the part on stock and stockholders. This chapter is divided into two parts. The first deals with the procedure necessary to secure a charter, with some remarks upon the advisability of incorporating and the choice of the state of incorporation. The second part deals with such points upon the internal organization as are not more conveniently treated elsewhere.

A. In Respect to Securing the Charter.

Sec. 15. WHETHER TO INCORPORATE. In each particular instance the peculiar circumstances that prevail must be taken into consideration to determine

whether the corporate form is or is not the most advisable for that particular business.

We have heretofore noted the reasons upon which businesses are incorporated, but it by no means follows that it is the wisest plan to incorporate every business. If, for instance, a business is quite small, especially if it is not owned by several partners, there would usually seem to be no good reason for incurring the expense or going to the trouble to incorporate. Especially would that be so if the conduct of the business was the main occupation of the owner and not a side line managed or conducted for him by others. Against the advantages which follow incorporation may be mentioned a number of disadvantages. A stockholder in a corporation does not have that immediate and direct control over the business which a partner has. The stockholder, as we have noted, is not even an agent of the corporation, unless specially made such agent; but a partner is an agent of very general and wide powers. He has a right to both a voice and a hand in the management. So it is a fundamental principle of the law of partnership that the relation is a highly personal one. No partner can by transfer of his interest put any one in his stead. No one can even withdraw without giving each other partner the right to demand a winding up of the business. But stock in a corporation may be freely transferred unless it has been agreed otherwise, and even then a stranger who buys stock is not subject to such restrictive agreement unless he has knowledge of it, and so might come in notwithstanding any such agreement. It is to be remembered also that corporations are subject to many

drastic laws in respect to taxation, publicity, filing reports, etc., which have no application to partnerships, or to a person conducting an unincorporated business. It is to be noted therefore, that there are often some things to be said in favor of not incorporating. It is true that if a business is very extensive and many times also where it is quite small, the advantages of incorporating often greatly outweigh other considerations. This is especially true because of the limitation of liability which follows incorporation, and that limitation probably furnishes the greatest incentive to incorporate.

Sec. 16. WHERE TO INCORPORATE. As a general rule it is better to incorporate in the state in which the operations of the corporation are to be centered, but for special reasons it may be better to seek some other state whose laws are more liberal in certain respects, or where special provisions apply.

Having decided to incorporate, the question of the choice of the state then arises. If the business of the corporation is local and it is carrying on one of the ordinary staple lines of business, and the capital is all, or in large part, paid in, the state of incorporation should be the state in which the operations of the company are carried on or center. This may result in incorporation under laws more drastic than those of some other state, and may subject the incorporators to larger fees than they would otherwise have to pay, but these disadvantages are offset by the fact that the company is incorporated under the laws of the state where it does its business. For, if it is not incorporated under the laws of the home

state, it is a foreign corporation in the state in which it must look for its most important protection, and as such foreign corporation it is subject to all of the foreign corporation laws, more or less severe, of the state where it has its home. Furthermore, incorporation in such other state means that there must be constant compliance with the perhaps changing laws of that state, the keeping of the necessary agents and the holding of the necessary meetings there, and so on.

Perhaps, however, the corporation is to be organized for a much larger capitalization than can be at present paid up, or perhaps all stock is not at present to be subscribed, and the requirements of the home state in these and similar regards cannot be met, or perhaps the operations of the company are to cover many states, with branches in numerous cities, and stockholders widely scattered, or the company is to be of such a large capitalization that a more favorable state in regard to incorporation fees must be sought; for these, and other reasons, it may, in any particular case, appear upon full consideration to be better to incorporate in some particular state whose corporation laws are more favorable.

The corporation laws of some states are much more liberal than those of others. Some states have been notorious in this respect. But in all the states parties can secure incorporation to carry on legitimate lines of trade and commerce and where the real capitalization approximately corresponds to the nominal capitalization, it is not necessary to go to foreign states.

Sec. 17. ADOPTION OF NAME. Except for the provisions of certain states concerning the name, a corporation may adopt practically any name to which some other corporation, partnership or individual has no right, and this name by usage may acquire great value and will be protected by the courts.

In the formation of a corporation the choice of a name which shall distinguish it becomes necessary. If the business is already a going business and has a good will, it is usually desirable to continue under the same, or a similar, name. If the company is newly organized, then the matter of selecting a name often becomes one of considerable perplexity. The particular circumstances must, of course, govern the choice.

The name may be practically any name the incorporators determine upon. Thus it may be the name of a person, as "Marshall Field & Company" or it may be purely arbitrary, as "The Fair" or "Standard Oil Company," etc. In some states there are special statutes that have to be considered, as for instance in Ohio, a law that all corporate names shall begin with "The" and end with "Company."

A name should not be adopted which is similar to that of an existing concern. If one adopts a name in order to attract to himself the trade that ought to go to another who has a similar name, an injunction will issue against using such name, for it is a species of unfair competition. A name becomes by use a valuable asset and the courts will prevent trespasses upon it.

Sec. 18. PROCEDURE NECESSARY TO OBTAIN CHARTER. The general corporation laws of the various states set out in detail the steps to be taken to

bring a corporation into being. These consist in filing and recording various certificates containing statements of fact respecting the object of the incorporation, its name, capitalization, etc., and in paying the prescribed organization tax.

We have already seen that the states now have upon their statute books, general corporation laws under which incorporation must be brought about. Incorporation, then, becomes a matter of compliance with these laws. Any persons complying with these laws are entitled to do business as a corporation and their charter cannot be arbitrarily withheld from them.

The provisions of some of the states in this respect are more onerous than those of others. They all differ in some respect. But in a general way, the procedure is similar. It does not consist in the application to the legislature as formerly, but in doing certain things required by law, in stating to the proper officers, as for instance the secretary of the state, that those things have been done and in filing and recording in the proper places all the necessary papers.

As an illustration, the procedure under the general corporation law of Illinois is as follows: First, a statement is filed with the secretary of state, signed by not less than three, nor more than seven commissioners, stating the name, capitalization, location of principal office, objects and duration of life, of the corporation proposed. The secretary of state issues a license empowering the commissioners to open subscription books. The commissioners must then secure subscriptions to *all* of the capital stock, one-half of which must be paid in, in money or money's

worth. The commissioners then convene a meeting of all the subscribers, directors are elected, and other constituent business performed. The commissioners then make a report to the secretary of state, and he thereupon issues a *Certificate of Complete Organization*, containing a copy of all prior papers. This is filed in the office of the recorder of the county where the principal office is located, and the incorporation is then complete.

As another illustration, the laws of the State of New York provide that three or more persons may form a corporation. They shall make a certificate setting forth the name, the purposes, the capitalization, the location of the principal office, the duration of life, the number of directors, etc., which certificate shall be filed with the secretary of the state, and a duplicate or certified copy thereof with the recorder of the county where the principal office is located.

These examples are given here simply to indicate the general form of procedure. The statutes of each state must be consulted for variations. Strict compliance with these laws is necessary to give corporate life, and if business is carried on without such compliance, a personal liability for all acts done is entailed, for there is no corporation to which such liability may attach.

B. In Respect to Internal Organization.

Sec. 19. FIRST MEETINGS AND ELECTIONS OF DIRECTORS AND OFFICERS. The proper organization of a corporation involves one or several meetings of

the subscribers to the stock and of the directors elected by them. It also involves the election of the officers of the corporation for definite terms.

Where a corporation is formed, there are a number of meetings to be held at which the organization is effected. In some states certain of these meetings must be held before incorporation is legally complete, but elsewhere they may all follow. The first meeting to be held usually is that of the subscribers to the stock. At this meeting the first board of directors is usually elected, and also by-laws may be adopted or a committee appointed to draw them up, unless the power of making by-laws is in the directors (as in some states). Other business naturally comes up to be disposed of, as, perhaps, in what medium or property the subscriptions or some part of them may be paid although the directors should finally dispose of this matter.

After the directors are elected, they meet to elect officers and perform other business. They also consider propositions to exchange property or services for stock and vote upon it. It is better that stockholders and directors both vote upon such a proposition.

The minutes of the first meetings should be carefully made and in the minutes of the directors, at least, such propositions as those to exchange property for stock should be incorporated. Forms of minutes for meetings are set out in the appendix.

The required notices for these meetings must be given unless waived. The law customarily provides

a certain notice to be given, but it can be waived by those entitled to it.[7]

Sec. 20. THE BY-LAWS. Incidental to the organization of corporations is the enactment of by-laws, which are rules passed for the internal government of the corporation, alterable at the pleasure of the corporation and binding upon the stockholders so long as regularly enacted and so long as they are not contrary to the law or the charter of the corporation or in contravention of common right or public policy.

The enactment of by-laws while usual and necessary to the proper management of corporations, is not, like the securing of a charter, essential to corporate existence. The by-laws are the general rules or regulations enacted by the pleasure of the corporation. They are binding on the stockholders and upon the directors, and other officers, so long as they are not opposed to the company's charter, or the law, or public policy of the state.

It has been said that the by-laws are to the members of a corporation what acts of the legislature are to the citizens of a state while a charter is like the constitution.

A by-law differs from a resolution in that the latter is passed not as a general rule of conduct, but to provide for some special case or emergency. A resolution usually concerns some temporary or unusual matter, while the by-laws provide rules of conduct and general provisions of a permanent

7. J. W. Butler Paper Co. v. Cleveland, 220 Ill. 128 (the 10 days' notice of the meeting of subscribers to be given them can be waived by them).

nature. Thus, if it should be desired to empower the president to purchase a certain piece of real estate, the usual form of authorization would be by a resolution regularly passed at some meeting of the board of directors and recorded in the minutes thereof. A by-law may, however (though this is not usually the case), be put in the form of a resolution.

By-laws must be reasonable and fair; they must operate equally. They cannot deprive the stockholders of their fundamental rights except by unanimous consent.

The by-laws should concern such subjects as these: the qualifications and duties of directors and other officers; the terms of office; the bonds of officers; the dates of regular meetings; how special meetings may be called; and so on. Reference to the form of by-laws set out in the appendix will suggest the usual provisions of by-laws. By-laws should be full rather than scant. And yet this depends to a degree upon the circumstances of the particular corporation: whether it is large or small; whether there are many or few stockholders; whether the stockholders are the officers, etc.

By-laws are more readily alterable than charters. A vote at a meeting regularly called or where all interested are present, is sufficient. If all concerned are present by-laws may be suspended temporarily; and as to mere matters of form could be suspended at any meeting. But a charter cannot be amended except by application to the state, the compliance with the technical requirements, the payment of the fee, etc.

By-laws should be strictly observed by those governed by them. Any violation may lead to personal

liability. So far, however, as third persons are concerned, a corporation may by its conduct waive the by-laws. Where one is dealing with an officer or agent of the corporation in the general conduct of its business he is not concerned with the provisions of the by-laws. He can depend upon the seeming authority of such agent, that is to say, the authority with which the corporation seems to have clothed him.

Stockholders are bound to know the by-laws, and they are subject to them, so long as they are reasonable.

Sec. 21. OPENING OF CORPORATE BOOKS AND RECORDS. Upon the organization of a corporation the usual books of account necessary to good bookkeeping should be secured; the accounts of the corporation should be carefully and separately kept; and there should be also opened the books in which the acts of the corporation, as such, are to be recorded, as minute books, transfer books, stock books, etc.

(1) IN GENERAL. We may divide the books which a corporation should keep into two general classes, first, the books which are regularly kept in any business, whether incorporated or unincorporated, in which the bookkeeping is properly done, such as cash books, journals and ledgers; and second, the books which the corporation must have because it is a corporation, as stock ledgers, transfer books, minute books, etc.

Of the first set of books it should be said that the corporation should be prepared to keep full and correct accounts of all its business, and that these accounts should be kept as the accounts of the com-

pany. This advice may seem superfluous to some, inasmuch as every business, if properly conducted, whether it be incorporated or unincorporated, should have its books, yet how often it is that the parties conducting a business, keep the accounts thereof in a more or less irregular way; and such accounts often have very little or indeed no distinction from the personal accounts of those who take the profits of the business. This is of course fundamentally wrong in the management of any business, but in the management of a corporation it is wrong in a double sense. For not only is the corporation a thing apart from its owners from the standpoint of good bookkeeping, but also it is distinct in *a legal sense,* and the confusion of the business of the corporation with the business of its stockholders or officers or agents, may lead to unfortunate consequences. Even if one owns all or practically all the stock of the corporation, he should be just as careful as ever to keep its business and his own entirely distinct. It should appear what the expenses of the company are and what its disbursements are. If the stockholders are to draw out the profits of the business they should do so regularly by way of salary or of dividends. These remarks are prompted by the fact that many businesses are loosely conducted in this respect. The incorporation of a company should lead to a careful system of bookkeeping.

Besides these books of account adapted to keeping straight the accounts of the company, there should be all books necessary to record the actions of the corporation as such, but how extensive these should be depends considerably on the size and circumstances of the corporation.

The usual books of record are as follows:

(2) THE MINUTE BOOK. In this the minutes of the stockholders and of the directors should be kept. The by-laws are also usually enrolled therein, and sometimes the Certificate of Incorporation is attached to one of the front pages. What the minutes should contain and other particulars are stated elsewhere. In large corporations there may be separate minute books for stockholders and directors meetings.

(3) THE STOCK CERTIFICATE BOOK. This consists of a number of blank stock certificates in the form authorized by the directors, numbered consecutively and attached to "stubs" which contain corresponding serial numbers. These certificates are detached from the stubs as required and filled in with the name of the stockholder and the number of shares which it represents. The stub contains a record of the transaction. See, further, the chapter on Transfer of Stock.

(4) THE STOCK LEDGER. No separate stock ledger is kept in some of the smaller corporations and in some it is contained in the back of the minute book. In fact books specially prepared for such combined purpose are purchasable from the stationers. But it is usually better to have a separate stock ledger and in some states laws require a stock ledger to be kept, available at all times for inspection by the stockholders upon demand. The stock ledger shows at a glance the history of the stockholder's relationship to the company and his present standing, so far as he has put the same of record with the officers of the company. It contains the name of each recorded stockholder, alphabetically arranged,

his address, the number of shares owned by him, the date and source of acquisition, the date of the disposition of any shares and to whom disposed, and how much stock remains to his credit. Statutory provisions may require other details.

(5) The Transfer Book. This consists in a series of blank transfer forms to be filled out and signed by the transferor or his agent. When stock is transferred, it is usual to fill out a power of attorney on the back of the certificate appointing the transferee or some other person the agent of the transferor to make the transfer on this book.

(6) Corporate Calendar. The secretary should make a corporate calendar which should cover the entire year and should indicate to him the days on which notices are to be sent, meetings are to be held, taxes are payable, reports to state officers are due, and all other matters which he must attend to on certain days.

(7) Other Books. Besides the books mentioned, other books may be desirable, especially in the larger corporations, as for instance, a subscription book (but in smaller corporations subscriptions could be pasted in the minute book or stock ledger); dividend books (supplied in many cases by a voucher system); a bond register, etc.

CHAPTER 4.

THE PROMOTER.

Sec. 22. PROMOTER DEFINED. A promoter is one who undertakes to organize and secure the incorporation of a company, securing the necessary subscribers and funds, and obtaining or taking steps to obtain the charter.

A promoter is one who organizes an enterprise and secures its incorporation. It is not necessary in every case that there be a promoter, in the sense that that word is commonly used. Companies are incorporated in great numbers without the assistance of any one who could properly be termed a promoter. But where an enterprise is new and where some idea is to be exploited, and subscribers are to be secured in large numbers, there is usually a person or a number of persons who are fitly described as promoters. They undertake to build the corporation and launch it upon the sea of business. They secure the necessary subscribers, often they secure valuable patent rights, options upon land, etc., and take the necessary steps to secure the charter.

Sec. 23. LIABILITY OF THE CORPORATION FOR ACTS OF THE PROMOTER. The corporation is not liable upon the contracts made by promoters prior to incorporation, except where after incorporation the

corporation steps into the promoter's place and adopts his contracts. Such promoter is personally liable on his contracts made prior to incorporation.

For the acts of the promoter which he does prior to incorporation, the promoter is personally liable, and the corporation upon coming into existence does not become liable unless it can be said that it adopts the acts of the promoter. Thus a promoter might go to considerable expense in securing the charter and yet the corporation be in no sense liable for his acts. He cannot represent it as an agent, for it has as yet no existence.

After the corporation comes into being it may take the benefits of what a promoter has done, in such a direct and substantial way, that it ought to be held upon the contracts made in respect to such benefits. In such case the law will hold the corporation liable by adoption. Thus, where it comes into possession of property contracted for by the promoter, knowing the circumstances, it could be held, as though the promoter in making such contract had been its agent.

Sec. 24. THE PROMOTER IN A POSITION OF TRUST. A promoter is in a position of trust toward subscribers and the corporation. He must exercise the utmost good faith, making full disclosures and taking no secret profits.

A promoter stands in a position of confidence. It is true that there are many instances in which promoters have greatly abused their positions and have exercised anything but good faith. Yet the law is strict that a promoter is in a position of trust

and must make full disclosure of all material facts where he deals with the subscribers or the corporation and is not entitled to secret profits. Thus a promoter cannot sell to a corporation at an advance in price property which he has secretly purchased and which he pretends to be selling as agent for another. Or if he acts as apparent owner he cannot misrepresent the true cost to him. The promoter can make a profit if all consent as where the transaction is open and full disclosure of the facts has been made.

The promoters legitimate profits are often very large. His services are very valuable and he creates a means of wealth for those who employ him or become his co-adventurers. To these profits which are to come to him as promoter and which he contracts for he is entitled. Such profits often come to him in the shape of a portion of the stock.

PART II.

STOCK AND STOCKHOLDERS.

CHAPTER 5.

DEFINITIONS AND KINDS OF STOCK.

Sec. 25. DEFINITION OF CAPITAL STOCK AND SHARE OF STOCK. The capital stock of a corporation is the amount of capital which it is authorized by law to receive from subscribers with which to do business. A share of stock is the unit of interest held by the stockholders, the number of which, held by any stockholder, determines the amount of his liability to contribute to said capital stock.

Every stock corporation has a certain capitalization provided for in its charter and the capital stock may be defined as that fund contributed, or to be contributed, by subscribers that the corporation may pursue its objects. How much each subscriber shall contribute is determined by the number of shares he holds.

The amount of capital stock of a corporation is always determined by its charter. But that amount may be increased or diminished by amending the charter in that respect upon compliance with the law of the state in which incorporation was had. In no other way may the capitalization be increased or decreased. Where the amount is increased, we

have seen that the present stockholders may, if they choose, subscribe pro rata for the new shares.

Sec. 26. COMMON AND PREFERRED STOCK. The stock of a corporation may be divided into common and preferred stock; though in the majority of corporations, especially the smaller ones, all stock is of one sort, that is, common. Preferred stock is that stock which entitles the holders to share in the net earnings of the company up to a named per cent in priority to the common stockholders.

Many corporations—most of the smaller ones—have only one quality of stock, but in other corporations there are two sorts of stock, one of which is preferred before the other up to a certain per cent in the matter of dividends, and perhaps also in the matter of distribution of assets upon dissolution.

Stock which is preferred as to dividends is either cumulative or non-cumulative. If it is non-cumulative the dividends to be paid in any fiscal year are governed by the earnings of that year alone. If cumulative, the dividends unearned and unpaid during any year are payable from the earnings of subsequent years. The particular language used in each case must be carefully considered. If, however, there is no express provision in that regard, it will be presumed that the stock is cumulative.

In any carefully organized corporation the exact extent and nature of the preference would of course be indicated with particularity.

The earnings are to pay the dividends of the preferred stock up to a certain per cent, as, for instance, six per cent. Above that amount the common stockholders are entitled either to the whole of the fund

set aside for payment of dividends, or, in some cases, to share such fund in common with the preferred shareholders. It sometimes happens that the earnings of a corporation are so large that the common stock pays at times a larger dividend than the preferred stock and has a higher market value.

Preferred stock is issued for the purpose of securing subscriptions not otherwise obtainable, as it gives one a more certain return upon his money. At the same time, a preferred shareholder is *only* a shareholder and if the corporation becomes insolvent he can not compete with creditors. The stockholders have no right in the division of the assets until the creditors are paid, and this is as true of preferred as it is of common stockholders. If a corporation pays its debts, and upon dissolution the stockholders are entitled to the assets, the shareholders who are preferred as to assets as well as dividends are first to be satisfied.

In another sense, also, preferred stockholders are not creditors of the corporation. They cannot sue the corporation for the dividend until it has been declared by the directors and the directors have a certain discretion in that respect even though there may be net earnings available for that purpose, yet if the directors abuse their discretion, the preferred stockholders can compel a declaration of dividends in a suit brought for that purpose.

Preferred stock is sometimes called "guaranteed stock."

Preferences in stock cannot be created after the common stock has been subscribed for without the consent of all the stockholders, for this would result in an unwarrantable cheapening of the common stock.

Sec. 27. UNISSUED AND TREASURY STOCK. Unissued stock is that stock which has never belonged to any stockholder. Treasury stock is that stock which, having been once issued, has been reacquired by the corporation.

All the stock of the corporation may not have been subscribed for at its organization, for in many states this is not required. Stock unissued is called "unissued stock." Issued stock reacquired by the corporation is called "treasury stock."

Sec. 28. THE CERTIFICATE OF STOCK. The stock certificate is a written acknowledgment by the corporation that the person therein named is the holder of so many shares of stock.

The certificate is the written evidence of the ownership of the stock. It usually is made to a particular person. Such certificate is not essential to membership in a corporation, but it is highly convenient for purposes of protection and transfer. A stockholder is entitled to such certificate and may compel its issuance. In fact, in order to facilitate transfer he may ask that his stock be divided into any number of certificates, so long as he is reasonable about it.

The secretary, or the transfer clerk, if there be one, issues the certificate. It is usually signed by the president, and is under the corporate seal with the attestation of the secretary.

The transfer of stock, the right to compel dividends, the liabilities of stockholders, and other matters concerning stockholders are discussed in the following chapters.

CHAPTER 6.

SUBSCRIPTION TO STOCK.

Sec. 29. FORM, MANNER AND EFFECT OF SUBSCRIBING TO STOCK. A stock subscription need not be in any special form, but should, as a matter of fact, be made upon the books of the company or some carefully drawn subscription contract that may be kept in the corporate records. An accepted subscription constitutes a contract between the subscriber and the corporation.

One becomes a stockholder of a corporation either through subscription to its stock or by purchasing outstanding stock—that is, stock which some one else originally subscribed for and which was issued to him. In this chapter we are simply to note how subscriptions are made, and to consider that, when accepted, they constitute a contract between the subscriber and the corporation.

A subscriber to stock may be in one of these possible situations:

First: In respect to whether he is offeror or offeree. That is, the corporation may propose to take him as subscriber, or he by his subscription may propose to buy stock. In either case a contract results upon acceptance by the offeree, and little importance rests in the distinction except in the perhaps rare cases where either the corporation or the subscriber desires to withdraw and claims that right just as any

offeror in any contract has a right to withdraw unless and until his offer has been accepted. In that case it might be material who was offeror or offeree, Acceptance in the case of the corporation may be and indeed usually is, *implied* from its conduct, for it is not necessary that there be any express acceptance.

Second: In respect to whether the corporation has been formed or is merely projected. If the corporation has not yet been brought into being, it cannot be an offeror. It becomes an offeree of previous subscriptions upon coming into existence unless the offers have before that time been withdrawn. But parties may, before incorporation, make, among themselves, a valid contract to subscribe, so that withdrawal would amount to a breach of contract.

Some state laws provide that all the stock or a certain percentage thereof must be subscribed before a corporation shall be entitled to its charter.

A form of subscription contract is set out in the Appendix.

Sec. 30. FRAUD IN SECURING STOCK SUBSCRIPTIONS. For fraudulent misrepresentations of fact made to a subscriber by a duly authorized agent of the corporation, and relied upon by him, he may defend against payment of the subscription, or if payment has been made he may have rescission, provided, however, he has not been guilty of negligence in asserting his defense or claim, and provided the corporation has not become insolvent.

If a corporation, having unissued shares, gives authority to agents to sell those shares, such agents may, in their zeal or cupidity, make statements that are false, and thereby accomplish the sale of the

shares. One who subscribes upon such false representations may defend against payment, or if he has paid he may have rescission of the contract, provided he acts with diligence, and provided the corporation has not become insolvent. This does not mean that it is necessary for the corporation to positively authorize the fraud, but means that if it desires to take advantage of the acts of its agents in such cases it must accept the responsibility for the fraudulent representations made in its name and upon its apparent authority and behalf.

The fraud which will enable one to avoid his subscription consists in a misstatement of fact, made to be relied upon and which is actually relied upon by the party to whom it is made.

It is a general principle of the law of sales that the statement of a mere *opinion* or *prediction,* no matter how highly colored, and though in fact made contrary to the seller's own belief, constitutes neither fraud nor a warranty. Every one is bound to take a mere opinion or prediction at its real value. Every person is bound to know that opinions and predictions in sales are nothing upon which a person may base a legal right. Sellers will "puff their wares" and use extravagant language. Thus a prediction that stock will rise in value is not a representation upon which anyone can rely in any definite way. But if a *fact* is stated, that is something about which the seller may *know,* consequently the buyer may rely upon such statement and hold the maker to its truth. Thus, the assertion that the output has been so much, that dividends have been paid, that the corporation owns certain property, are all statements of facts, which, if made to induce and

do actually induce the sale, constitute representations for the untruth of which a defense to the suit for the subscription may be made or rescission may be asked by the buyer.

Statements in a prospectus issued by the authority of a corporation are binding upon it and enter into the contracts of those who subscribe on the faith of such prospectus. While opinions and predictions therein stated must be regarded as such, yet in the statement of facts the prospectus must be honest and fair. And it must not give wrong impressions by omitting material facts.

Where a company is yet to be incorporated, the promoters or commissioners have no real or seeming authority from it to make representations, and therefore it has been held that the defense of fraud cannot be made in such cases, but the subscriber is left to his action for damages against such promoters or commissioners.

Where one has a right to withdraw on account of fraud, he must act diligently. Unexplained delay for more than a reasonable time will amount to a ratification and bar him of his defense.

Usually it is also held that the insolvency of the corporation prevents an assertion of fraud, because the apparent assets of the corporation would be thereby depleted to the injury of creditors.

This subject of fraud and misrepresentation by the corporation through its agents must not be confused with that of a sale of outstanding shares by the owners thereof. Whatever fraudulent or other assertions are made in such cases are of course not made in behalf of the corporation, for such owners are not acting as agents of the corporation, but as their own principals.

Sec. 31. SUBSCRIPTIONS UPON CONDITION. A subscription made upon some condition cannot be enforced unless the condition is performed, provided the condition is not secret and therefore a fraud on other subscribers and on creditors, and, provided, it is not objectionable as an oral variation of a written contract.

By a contract properly drawn subscribers could succeed in imposing a condition to be performed by the corporation before their liability is to attach, but more frequently it seems that where a defense is made that a condition has not been performed, the contract of subscription is a seemingly absolute one, and the condition is secret and perhaps oral. Now the capital stock of a corporation is a fund paid in or to be paid in by its subscribers and stockholders that it may conduct its business and pay its liabilities. Whenever, therefore, a subscriber imposes some secret condition that he shall not be compelled to pay his apparent obligation unless some land of his is purchased, or some work is done to his advantage, or some property of the corporation is located near his property, or some other undertaking of some sort is accomplished, he is imposing a condition, which, if enforced, may go to deplete the fund to which creditors have a right to look for the payment of their debts. It is accordingly held that such secret conditions are void and the subscription may be enforced as an absolute one. Futhermore, it is a well known rule of law that where one makes a written contract he cannot alter the terms thereof by setting forth a collateral oral agreement which he claims was to stand in the stead of the written one. The writing must govern.

CHAPTER 7.

PAYMENT FOR STOCK.

Sec. 32. LIABILITY UPON UNQUALIFIED SUBSCRIPTION. The liability of a subscriber to stock is to pay the corporation the par value thereof, unless otherwise agreed; and no more can be called for or assessed, unless otherwise agreed.

When one subscribes to the stock of a corporation either before or after the charter is secured, his liability, upon the acceptance of his subscription, is to pay the par value of the stock subscribed for, and no more or less unless it has otherwise been agreed. When he has paid that amount, no further calls can be made upon him and he is liable to no further assessments.[7a] We have already considered that one purpose of incorporation, very often the chief or perhaps the only one, is to limit one's liability to a definite amount—the par value of the shares taken.

But a contrary agreement may be made. Stock may be offered to a subscriber below par; or assessments may be provided for as a part of his contract of subscription. In all such cases the agreement really made would be binding upon the corporation and the subscriber. Whenever other stockholders would be thereby defrauded or, as we shall see, creditors would be deprived of payment of their debts, such special agreement might not stand.

7a. In California and one or two other states fully paid stock may be further assessed.

Sec. 33. MEDIUM OF PAYMENT. Payment of stock may be either in money or other property as agreed upon.

Whether stock must be paid in money or in other property depends upon the agreement between the subscriber and the corporation. There is no reason for holding that a corporation may not receive payment of stock in any kind of property. The corporation must have property of various sorts, and may as well pay for it with certificates of stock as in money which it receives for such certificates. Often the corporation is organized to take over an existing business and they who are to own the shares are the owners of the business to be taken over by it. In such a case, the business is valued and then transferred for that value to the corporation, and shares are issued to its owners. To provide that payment must be in money would in many cases mean that money must be paid to the corporation by the person to whom it is to be immediately returned for the property he is to convey.

Payment for shares may even be in services rendered to the corporation, but these services must be actually given, and they must be given pursuant to and in consideration of the issuance of the stock. And if the stock is issued for services, which are yet to be rendered, it is unpaid stock until the services are actually rendered and if they are never given the stock must be paid for in some other way, or else it is unpaid.

Sec. 34. DEFINITION OF "WATERED STOCK." Stock is said to be "watered" when it is issued by a corporation either under an agreement with the sub-

scriber that he need not pay the whole or that he need not pay some part of the par value of such stock. In other words, it is stock which in whole or part does not represent real value, but which purports to represent such value.

"Watered stock" is that stock which is issued at some discount, usually a heavy one, from the par value or which indeed is issued entirely as a bonus to the subscribers of other stock. It is stock which is meant to pass upon the market as "fully paid and non-assessable" when, as a matter of fact, it has never been paid and really represents no value whatever or, at best, represents only part of the value expressed upon its face. It is usually issued for the purpose of enabling those to whom it is issued to resell it upon the market at an advance over what they have paid for it in order to profit heavily. Frequently it is issued in exchange for property or services purposely overvalued. We shall see in subsequent sections what rights creditors have in respect to the payment of such stock, and consider some of the difficulties connected with this subject, the chief one of which perhaps is the difficulty of discovering whether or not property received in full payment for stock has been purposely and dishonestly overvalued.

Sec. 35. RIGHTS OF CREDITORS RESPECTING PAYMENT OF STOCK SUBSCRIPTION. Where creditors of a corporation remain unpaid by it, they may demand that the subscriber pay the par value of his stock and that fraudulent and gross overvaluations of property received for stock be ignored or set aside.

We are not now considering, as such, the rights of creditors of the corporation, yet the question of

the stockholder's liability upon his stock is so involved with the rights of creditors that it is better to consider the rights of creditors in that respect at this point. When one subscribes for stock he desires to know to what extent he is liable thereupon, whether it be at the suit of the corporation or at the suit of the creditors in some insolvency proceeding.

The capitalization of the corporation represents the amount which it is entitled to receive from subscribers with which to carry on its business, and the subscribers are those who have apparently agreed to pay in as much of this amount as the number of shares held by them would indicate. If a corporation seems to have a capital stock of $50,000, all of which, or a certain part of which, is subscribed, this indicates to the world that it has received or is entitled to receive that much from its subscribers as a fund with which to carry on its business and pay its debts. It has been laid down, therefore, with more or less strictness by the different courts, that when a corporation becomes insolvent, subscribers are responsible at the suit of the corporate creditors for the par value of the stock subscribed for by them, with little regard to any contract between subscriber and corporation attempting to limit the liability, and this liability persists in many states even though one has sold his stock to another until either he or someone else in the line of transfer has paid the par value of that stock to the corporation.

Starting with the case of one who subscribes to the capital stock of a corporation under an agreement to pay its par value, it may be said that not only can the corporation have judgment for what-

ever upon call remains unpaid, but creditors in a proper proceeding may compel the payment of so much thereof as is necessary to satisfy their claims; and the corporation cannot give any release of that liability in whole or part which will be good as against the creditors of the corporation. Where one has subscribed for stock at its par value, he should know that if the corporation becomes insolvent he may be compelled to pay the entire amount of his subscription though he has an agreement with the corporation otherwise. It is no defense in such a case that other subscribers have not paid.

If one does not agree to pay the par value, but subscribes for it at less than par, such an agreement may be good as between corporation and subscriber but is not good so far as creditors are concerned; they may ignore any such agreement and insist that the stockholder pay the entire par value of his stock if that becomes necessary to satisfy their claims. In some states, however, if the creditor at the time his contract is made, *knows* that the subscriber has such agreement with the corporation limiting his liability, he cannot insist that the subscriber pay more than he agreed, on the ground that he could not have relied upon such liability as an apparent asset of the corporation; but in other states the creditor's knowledge is immaterial.[8]

This case should not be confused with the one where a person buys shares from another stockholder, as where he purchases a certificate on the market. If that stock was once fully paid, it cannot

8. See case note, 8 Lawyers' Reports Annotated, N. S. 271; Sprague v. National Bank of America, 172 Ill. 149.

matter how little an assignee pays for it. And even where not fully paid, the usual rule is that a purchaser who does not know of the fact, cannot be made to pay for the stock. This subject is discussed elsewhere.

Let us suppose that A. subscribes for ten shares in the M. Corporation, agreeing to pay the par value of $100.00 per share, and ten shares in the N. Corporation agreeing to pay one-half the par value of $100 per share. Creditors can force A. in each case to pay $100 per share. Whenever he has paid that to the corporation his liability is forever gone. But otherwise those whose debts the corporation cannot pay, can enforce the subscriber's apparent liability to pay the par value. This apparent liability is an asset which creditors may avail themselves of and exists whenever the corporation has not at some time either from the original subscriber or elsewhere in the line of transmission received the par value of the particular stock involved.

We now come to the more difficult cases in which *property* has been promised or transferred in exchange for stock and has been overvalued—either honestly or fraudently—by the parties. In such cases, the corporation, by our hypothesis, has been authorized in its charter to issue stock to and for a certain amount, yet by means of overvaluation of property, has issued that stock for a lower amount. The question might well be asked why there should be any difference in this case from the case where cash is paid or promised for the stock, and some courts answer that there should be none and that if a corporation issues, as it may, its stock for property, that property should and must have the value

which the stock represents. Courts which adopt this view enforce the rule that stock must be paid for in money or money's worth. This is the "true value" rule. In such a case, the stock must be considered unpaid in whole or part without much regard to the good faith of the directors or other officers of the corporation in making the valuation. This is the view of the Illinois supreme court, which has asserted in various cases that stock must be paid for in money or money's worth, that is if property is received for it, a valuation which it would have in open market must be placed upon it.[9] Yet even where this rule prevails, it is not believed that the courts would look too closely into an honest transaction where substantial value was received and the discrepancy was not great. Most, if not all of the cases, have been cases where the property had little, if any value, as for instance where worthless patent rights, formulae, etc., have been received.

Remember that we are now considering these transactions from the standpoint of creditors. As between the corporation and the stockholder, such transactions would of course stand as made.

Other courts adopt what is known as the "good faith rule" and will not overturn a transaction even for the benefit of the creditors where, though the property was overvalued, there was *no bad faith* or dishonest purpose in doing so, but the directors honestly believed that such property had or would have substantially that worth to the corporation.

9. Garden City Sand Co. v. Crematory Co., 205 Ill. 42.

Some statutes in various states enact this to be the rule, and elsewhere the courts have come to that view without the aid of any statute. It is the law everywhere that if stock is issued for property or services purposely overvalued, it is unpaid to the extent of the overvaluation. Even where the "good faith" rule prevails, there is such a thing as "constructive fraud," that is, such a gross overvaluation that in law it must be considered fraudulent.

Sec. 36. CALLS FOR PAYMENT. Stock may be issued for payment to be made at once or on call. If on call, there is no debt due until the call is made, but if the corporation fails the subscription is due at once without call.

If it is the agreement that stock or some part thereof is not to be due until a call is made, then such call is necessary before the stockholder's debt arises upon his subscriptions; and he cannot be sued until such call is made; neither will the statute of limitations run in his favor until such call.

A call is made by the directors.

A call is not necessary if the corporation becomes insolvent and comes under the jurisdiction of a court of equity or bankruptcy for the distribution of its assets among creditors. All subscriptions are then immediately due, and payment will be enforced to the extent necessary for the payment of debts.

A call is not necessary to enable the corporation to enforce payment unless the agreement is that the payment or some installment or installments thereof are not to be paid until a call is made. But if no date is mentioned for payment, the rule is

generally adopted that a call is then necessary. A subscriber may, however, pay at any time, though no call has been made.

Sec. 37. PAYMENT REQUIRED BY STATUTE AS A RIGHT PRECEDENT TO CORPORATE LIFE. In various states statutes provide that a certain percentage of the stock subscriptions must be actually paid in.

The statutes of the various states must be consulted with reference to this subject. As an illustration, the State of Illinois requires that fifty per cent of all the stock of the corporation (all of which must be subscribed for) must be paid in. This means that either the stock of one-half of the subscribers must all be paid for, or that various stockholders pay enough to equal at least one-half of the capitalization.

Sec. 38. FORFEITURE OF STOCK FOR NON-PAYMENT. In the absence of provisions in the by-laws or charter passed prior to the issue of the shares involved, there was no common law right of forfeiture for non-payment of shares. But that right is given quite generally by statute.

In case a subscriber does not pay for his stock, the right is usually given to declare a forfeiture of that stock. That right, however, is entirely statutory, and the provisions of the statute must be observed. It is usually provided that the stock must be sold and if any surplus remains after the debt is paid from the proceeds of the sale, the subscriber is entitled thereto. But if a deficiency result, the delinquent stockholder is liable therefor.

CHAPTER 8.

RIGHTS OF STOCKHOLDERS.

Sec. 39. IN GENERAL. A stockholder, as such, has no voice in the management of the corporation except as he votes at stockholders' meetings, but he has a right to insist that the management be honest and along the lines of the legitimate corporate purposes and he has a right to know what is going on. He may apply to the court in proper cases to protect these rights. A stockholder may freely contract with the corporation and thereby secure special rights against it.

We have already considered the status of the shareholder. It remains for us in this chapter to consider certain of his rights. Though he may not, except at stockholders' meetings, have any voice in affairs of the corporation, yet he has many rights in the way of protection of his interests which he may assert outside of stockholders' meetings. He has a right to know what is going on; to that end he may inspect the books of the company. He has a right to insist that the corporation shall pursue its proper corporate activities and none other; to that end he may apply to the courts for an injunction or other relief. He has a right to receive dividends; for that is the ultimate purpose of the corporation. Besides these rights which he has *as* a stockholder he may have other rights growing out of special contract,

for we shall consider in this chapter that a stockholder is under no disability to contract with the corporation in respect to matters upon which other parties might contract. These rights are considered in the following sections of this chapter.

A. The Rights Growing Out of the Stockholders' Relationship, as Such.

Sec. 40. STOCKHOLDERS' RIGHTS TO DIVIDENDS. The directors have a discretion in the declaration of dividends; but if this discretion is clearly abused, a court of equity will compel such declaration.

Dividends are not payable except upon a declaration by the directors. Though the corporation has a surplus out of which it clearly could and perhaps, ought, to pay dividends, yet so long as no dividends have been declared, none are payable. A stockholder cannot bring suit against the corporation for his dividend until after it has been declared, for until that time there is no dividend due. Neither will the court at the instance of a stockholder, or the whole body of stockholders, declare a dividend and then order it paid or give judgment. What remedy then, has a stockholder?

First let it be noted that the directors have a discretion in declaring dividends. This is true not only in regard to common, but even in regard to preferred stock, dividends upon which, as in the case of common stock, are not payable until a dividend has been declared. And this discretion is a large discretion in the case of common stock.

Yet, after all, the purpose of the corporation is that of profit for its stockholders. That purpose

cannot be indefinitely defeated. Accordingly, the law has been established that if the directors are withholding the declaration fraudulently or in bad faith, then a stockholder, upon making that appear, may have a decree against them in a court of equity that they declare a dividend.

Sec. 41. RIGHT OF STOCKHOLDER TO PREVENT ULTRA VIRES ACTS. A stockholder may, if he have no other means of relief, secure an injunction to prevent the directors or other officers of the corporation from carrying out ultra vires acts, or secure a rescission of them if executed.

Much in the same way that a citizen and taxpayer of a municipality may file a bill in a court of equity to prevent the officers of the municipality from paying out money on uses alleged to be illegal or upon ordinances alleged to be void, so may the stockholder in a corporation prevent the doing of those things which are beyond the power of ("*ultra vires*") the corporation. And if without such stockholder's consent or negligence, the officers of the corporation have executed illegal contracts, rescission of them may be obtained by the stockholder.

In such case, the stockholder must not be guilty of unexcused delay in bringing his suit, or of acquiescence in the act. He must also show that by an appeal to the other stockholders or to the directors he could not thereby secure relief, either showing that he has made such an appeal or that it would have been unavailing, if made.

Sec. 42. RIGHT OF STOCKHOLDER TO PREVENT A CHANGE OF THE CHARTER IN MATERIAL RESPECTS. A stockholder may prevent a change in object, amount of capitalization, etc., unless change is sought according to a general law authorizing such change by a vote of a certain percentage of the stockholders, and this law was in force when the corporation was formed.

There are now in most, or all of the states, laws which give the stockholders of a corporation a right to call a meeting for the purpose of voting whether or not the corporation shall seek an amendment of its charter to change or enlarge its purposes, to increase or decrease its capital stock, and to change its name, etc. If a certain per cent, named in the statute, say two-thirds, vote for such a change, there is a right under the statutes to secure it. A stockholder becomes a member of a corporation subject to this right of the majority according to the statute.[10]

Sec. 43. RIGHT OF STOCKHOLDER TO INSPECT CORPORATE BOOKS AND RECORDS. A stockholder may for the protection of his interests inspect the books and records of the company. His purpose, however, must be legitimate. He has no right to inspect the books to gratify idle curiosity or to secure information for the purpose of wrecking or injuring the corporation. And he must apply at a suitable hour, and must not impede the proper business routine of the corporation.

The directors and officers of the corporation perform their functions and keep the books for the

10. Smith v. Eastwood, etc., Co., 58 N. J. Eq. 331.

benefit of the real owners of the corporation, the stockholders. Accordingly it is the stockholder's right to see the books of the corporation in which the activities of the corporation are recorded and to take such copies thereof as necessary to make such inspection of avail. He need not show that the business of the corporation is being mismanaged. He need only show that he is a stockholder and that his purpose is a legitimate one, though under some statutes he need not show what his purpose is. This right of inspection the stockholder may enforce by mandamus proceedings.[11]

B. Rights Growing Out of Special Contracts Made by Corporation with Stockholders.

Sec. 44. RIGHT OF STOCKHOLDER TO CONTRACT AND DEAL WITH CORPORATION. A stockholder may enter into contracts with the corporation to the same extent as any person, except in reference to his subscription to stock, in which case the rights of creditors must be considered.

As the corporation has an entity distinct from its stockholders, the stockholders may contract with it and become its creditors, and as such creditors, (but not as stockholders) may compete with other creditors. Any contract, then, made by the stockholder not in his capacity *as stockholder* puts him on a level with any other creditor.

11. Stone v. Kellogg, 165 Ill. 192; Venner v. Chicago City Ry. Co., 246 Ill. 170.

Sec. 45. RIGHT OF STOCKHOLDER TO CONTRACT WITH RESPECT TO THE STOCK SUBSCRIPTION. The subscription must be paid at its par value in money or money's worth. Any contract with the corporation seeking to evade this liability is not binding as to the creditors.

We have already considered the subject of payment for stock. Creditors may insist that the full par value be paid. So, for the same reasons any contract with the corporation that stock shall be issued in the first instance at a discount, or that the liability of the stockholder shall be released, in whole or part, or that a demand against him shall be compromised are not binding on creditors.

It has been held, however, in a number of cases that if the subscriber is insolvent, a compromise made with him in good faith and for the benefit of the corporation, is binding.

CHAPTER 9.

STOCKHOLDERS' MEETINGS.

A. In General.

Sec. 46. RIGHT OF STOCKHOLDERS TO HOLD AND ATTEND MEETINGS. The stockholders have a right to hold and attend meetings for the purpose of transacting all such business as properly comes before them.

The stockholders cannot act except at stockholders' meetings. It is fundamental that they have the right to meet in order to elect directors, pass by-laws when that power is in them, and perform other constituent acts or any business that properly comes before them. Usually the by-laws set forth with considerable fullness the time and place of stated meetings and the manner of calling special meetings. The statutes of some of the states also provide how special meetings may be called.

If there is any attempt to block the proper calling of the stockholders' meetings, the courts may be appealed to, and by mandamus, injunction, or otherwise, will fully protect the rights of the stockholders.

Sec. 47. PURPOSE OF STOCKHOLDERS' MEETINGS. The commonest purpose of stockholders' meetings is to elect directors, hear reports of officers, vote upon changes in the charter, or any matter requiring

the action of the shareholders. But any matter touching the welfare or management of the corporation may properly come up for discussion, approval or authorization.

The stockholders' meetings are for the purpose of enabling the stockholders to get together to protect their interests and do those fundamental and constituent things which properly they must do. If there is to be an increase or a decrease of the capital stock, the stockholders must vote upon it; if there are directors to be elected a meeting is necessary for that purpose. And, also, there is a great deal taken up and considered which is not strictly necessary to be brought before the stockholders, yet which it is often for their benefit to discuss. They hear reports from various officers, they approve by formal vote the acts of the directors and other officers, they authorize acts which the directors might neverthless have legal right to do but which they now have also the moral sanction of the stockholders to do. They enlighten the directors as to their desires in reference to the policy of the corporation; they lend to or withdraw from certain activities their moral support; and thus in an indirect way they control the management of the corporation. The directors, we will find, have large powers and in their hands rests the immediate management of the corporation and they can carry on the regular business of the corporation without any special authority from the stockholders, and the stockholders cannot by action in the stockholders' meeting, usurp the offices of the directors. Yet with all of this, the moral support of the stockholders is very much to

be desired, and when stockholders express themselves definitely concerning the policy of the corporation, this, of course, has much influence upon the directors.

Stockholders' meetings, then, are for manifold purposes—to enable the stockholders to do those things which they alone can do; to enable them to state in concert and put of record their views as to the corporate policy for the guidance of the directors; and to enable them by discussion together to work out corporate problems.

B. Regular and Special Meetings.

Sec. 48. THE ANNUAL AND OTHER REGULAR MEETINGS. The most important regular meeting is the annual meeting and in many corporations there is no other stated meeting. The time and place of this annual meeting is fixed in the by-laws. At this meeting the directors are elected and other business done.

Corporations may provide for a number of regular meetings throughout the year, but usually there is only one regular meeting—the annual meeting. In any event, it is the most important regular meeting. At this meeting reports are read, directors are elected and other important business performed.

Much that is said throughout this chapter applies to regular or annual meetings and reference is therefore made to the other sections in this chapter for other particulars in respect to the annual meeting.

Sec. 49. SPECIAL MEETINGS. Special meetings may be called at any time as occasions require, pursuant to the provisions in the by-laws or by common consent. If there is no provision in the by-laws, the directors call special meetings. Statutes also give a certain percentage of the stockholders the right to call special meetings.

It is often important to call the stockholders together at various times to take care of some emergency that has arisen. The by-laws should provide for the calling of such meetings. No business can be performed at such meeting except that which is stated in the call unless all of the stockholders are present.

See the other sections throughout this chapter for further treatment.

C. Calls, Notices and Waivers.

Sec. 50. NOTICE OF ANNUAL MEETING. Notice of the annual meeting is necessary where the by-laws so provide. If there is no provision in reference to notice, some courts have held that it is not necessary. Yet as a matter of prudence such notice should be given and it is better for the by-laws to provide for notice.

The annual meeting need not, of course, be called, but the by-laws customarily provide that notice shall be given. It is better and is the usual practice to give notice of such annual meeting, and to provide for the notice in the by-laws.

Sec. 51. CALL AND NOTICE OF SPECIAL MEETING. Who may call special meetings has been indicated. Notice of such meeting must be given to every stockholder registered upon the books, the time and place and purpose of such meeting must be stated in the call and notice.

We have seen who may call special meetings. Notice of them must be given to every stockholder and this notice must state the time and place of the meeting and the purpose thereof. No other business than that specified in the notice can be done, unless, indeed, all of the stockholders are present. The secretary sends out the notices of the meeting.

Sec. 52. WAIVER OF NOTICE OF MEETINGS. The right to the notice provided by statute or by-law may be waived by the stockholder.

A stockholder has a right to waive the notice intended for his benefit. By this means it is possible to have meetings called immediately without waiting the prescribed time. Various forms are used for this purpose. One is the call and waiver comprised in one instrument where the stockholders appear as calling the meeting and at the same time waiving statutory or by-law notices.

D. Attendance and Vote.

Sec. 53. ATTENDANCE MAY BE IN PERSON OR BY PROXY. A stockholder may be present and vote

at any regular or special meeting in person or by proxy. The proxy's authority may be revoked at any time, though in terms irrevocable.

A stockholder may attend personally or he may send some one to attend for him. His representative is called a proxy and that is the name given also to his letter of authority, or it is called his "letter of proxy." It has been held that the proxy is always revocable, even though its terms may state that it is irrevocable.

This proxy is usually of very general nature, giving the representative full power to act on all questions that may arise. It should be produced and placed in the records.

Sec. 54. VOTING POWERS OF TRUSTEES, EXECUTORS, ADMINISTRATORS, AND PLEDGEES. Trustees, executors and administrators have the right to be registered as stockholders and may vote the stock they hold in trust. But pledgees by law in many states have no right to vote the stock, because the pledgor remains the stockholder and his transfer has not been for the purpose of making the pledgee a stockholder but to give him security.

If stock has been transferred to one in trust, or if he has acquired it as executor or administrator of the former owner, he may have himself registered upon the books as owner and vote the stock which he holds in that capacity. Indeed, it has been held in many cases that an executor or administrator can vote the stock standing in the name of the deceased, without the formality of having himself enrolled upon the books, provided he shows the proper evidence of

his title, that is, a certified copy of his letters of adminisration or letters testamentary.

A pledgee may stand upon a different footing. If A. borrows $50 from B., and as security transfers a stock certificate in the M. corporation to B., B. is not thereby made a stockholder. It may not be the contract of the parties that B. shall become a stockholder even upon default by A., but B. must sell the certificate, pay his debt out of the proceeds and turn over the surplus, if any, to A., the purchaser at the sale becoming the stockholder. In order to enable B. thus to enforce his rights, the stockholder signs the power of attorney on the back of his certificate and hands the certificate to B., and B. might, by virtue of his possession of the certificate, so endorsed, have himself registered as a stockholder and vote the stock and receive dividends. Yet if this has not been the special contract of the parties, B. has no right to do this and A. can according to some statutes by a proper showing of his status assert his rights.

A corporation cannot vote unissued or treasury stock.

Sec. 55. VOTING TRUSTS. The stockholders, or certain of them, may place their certificates in the possession of some person to hold the stock in trust for a certain period for the limited purpose of voting it at corporate meetings.

A voting trustee is one to whom all or several stockholders of a corporation have transferred their stock in trust to be transferred to them upon demand or after a certain period, meanwhile to hold

it for the purpose of voting it, and for no other purpose. Such stockholders receive the dividends during such periods and are in reality the stockholders, though divested of the record title for the purposes mentioned. This arrangement is usually held to be legal, and the stockholder is bound by it until the time stated has expired. It is legal notwithstanding only a portion of the stockholders are represented for the rights of the others are thereby not affected.

The purpose of such a voting trust is to secure the continuity of management and policy for a considerable time as desired by those who are parties to the trust.

The stockholder should have from the voting trustee a certificate or some sort of a contract asserting his rights.

A voting trust whereby the stockholders of several corporations combine to put the management of the several corporations in the hands of a common trustee or body of trustees for the purpose of stifling competition between such corporations, is illegal.[11a]

Sec. 56. WHO ENTITLED TO VOTE. CLOSING BOOKS. Those who appear upon the books of the company to be its stockholders are prima facie entitled to vote. The books may be closed for a reasonable time before the meeting to prepare a list of the stockholders entitled to vote.

The corporation usually looks to its books and not to outstanding certificates to determine who are stockholders. Often the transfer books will be

11a. See Sec. 125, *post*.

closed at a certain time, as for instance, at noon of the day preceding the date of the meeting, and if this is reasonable in view of the number of stockholders and other circumstances, to enable the secretary to prepare a list of the qualified stockholders, it is a valid provision, but the by-laws should be explicit.

Sec. 57. CALLING THE ROLL. It is important that the roll of those present be taken and preserved, together with the proxy of those who so appear.

If the stockholders of a company are few in number the enrollment of those present at any meeting is a very simple matter. If the stockholders are quite numerous but a roll may be called in a few minutes, then such roll should be called by the secretary. If the stockholders are so numerous that calling the roll is out of the question, then the stockholders may come forward and indicate their presence and file what proxies they hold for other stockholders.

The record of those who are present at any meeting should be carefully preserved by the secretary.

Sec. 58. QUORUM. A governing statute or the by-laws may provide what shall constitute a quorum. In the absence of any such a provision those who are present at any regularly called meeting constitute a quorum no matter how few they may be. If a quorum is not present no business can be done, but those present may adjourn to another time.

The laws of some states provide that a majority or some percentage shall constitute a quorum. In the absence of such a statutory provision the matter should be governed by the by-laws. Otherwise a

quorum is constituted by any number who attend in a regular or regularly called meeting. That is not so in a directors' meeting. In such case a majority must be present.

Where a quorum is present a majority thereof may carry motions and transact business.

Directors in their meetings have one vote each. But a stockholder in a stockholders' meeting has as many votes as he has shares of stock. The share of stock is the unit. Thus if one holds a majority of the stock he may outvote the holders of the minority, be they ever so numerous.

In order to give these minority stockholders a chance to be represented in the directorate, cumulative voting is provided for, as discussed in the next section.

Sec. 59. RIGHT TO CUMULATE VOTE. By statute and by-law the right to cumulate votes is sometimes given.

What the cumulation of a vote is may be thus explained. Three directors are to be elected. A stockholder may cast one vote per share held by him for each director, or three votes per share for one director. If the minority stockholders cast their vote in concert they may thus elect a director. This right does not exist by the common law but some of the state statutes give it. And the by-laws may provide for it.

E. Organizing the Meeting and Transacting Business.

Sec. 60. THE OFFICERS OF THE MEETING. The meeting selects its own chairman and secretary, unless it is otherwise provided in the by-laws. The president

or some other person can serve as chairman, but the secretary of the corporation should be the secretary of the stockholders' meeting.

The by-laws may provide that the regular officers of the corporation shall act as the officers of the meetings of the stockholders. In the absence of any such a provision the meeting can proceed to the election of its own officers. The secretary chosen should always be the secretary of the corporation as he has charge of the records and is familiar with the situation.

Sec. 61. ORDER OF BUSINESS. An order of business approved by usage in deliberative bodies should be adopted.

Having some approved order to follow facilitates the conduct of business, and assists the secretary in making the minutes. See the form of by-laws set out in the Appendix for a suggested order. This order although prescribed in the by-laws may be departed from whenever for some reason another order is desired.

Sec. 62. ADJOURNMENT. The meeting may either adjourn sine die, or may adjourn to some later date if all business is not disposed of.

If all business is disposed of then the meeting adjourns sine die. If several sessions are required to dispose of the business in hand, an adjournment to a particular time may be had. Where there is an adjourned meeting no notice of that meeting is necessary, as the stockholder receiving notice of the

meeting must take notice of its adjournments. At an adjourned special meeting no other business can be transacted than could have been at the original session.

F. Minutes of the Meeting.

Sec. 63. DEFINITION OF MINUTES. The minutes constitute the secretary's record of the business of the meeting.

The minutes comprise the record of the meeting. These minutes should be a recital in orderly form of all business disposed of. Debates, discussions, etc., should not be set down, but all resolutions should appear, whether passed or lost. It is better to state on whose motion and second the resolution was introduced. The minutes of a small corporation should contain the record of those present and whether in person or by proxy, but in very large corporations this is not practicable, and in that case the record of those present is kept by means of a list. By reference to any conventional form of minutes, one can readily infer what the minutes should contain.

Sec. 64. LEGAL EFFECT OF MINUTES. The minutes are the legal evidence of what transpired at the meeting.

The minutes become the legal evidence of what was done at the meeting, consequently they should be very carefully and accurately kept.

Sec. 65. APPROVAL OF MINUTES. Minutes of any special or regular stockholders' meeting can be read and approved or corrected at the next regular stockholders' meeting. But the minutes of a special or regular meeting cannot be approved at another special meeting.

The minutes are read and approved or corrected at the following regular meeting. If corrected by a majority of the stockholders the correction must be made by the secretary though he contend that they are correct. The original minutes with the correction should appear after the correction has been made. This can be accomplished by crossing out the corrected part leaving the words still legible and writing in the correction with red ink.

The secretary has charge of the minute book.

CHAPTER 10.

TRANSFER OF STOCK.

Sec. 66. TRANSFERABILITY OF STOCK. Stock may be sold, mortgaged or pledged. The transferee of stock acquires the rights of the transferor, but usually cannot take any further or larger rights.

One purpose of incorporating, as we have seen, is to give ready transferability of shares. Shares of capital stock are readily transferable, and, as we know, are bought and sold on the market, in great quantities, every day.

We say that stock is transferable or assignable, not negotiable. One who buys stock usually stands in the same position as his transferor. Yet he may have better rights where he relies upon recitals made by the corporation in respect to the stock.

Sec. 67. METHOD OF TRANSFER. The ordinary method of transfer is by indorsement and delivery of stock certificate, its surrender at the office of the corporation for a new certificate, and the enrollment of the name of the transferee upon the books of the corporation as a stockholder.

Where a stockholder has a certificate made out in his name and in the usual form, reciting that he is the owner of a certain number of shares of stock, the transfer of such stock to another may be accomplished in this way: the present holder signs his name

to the blank power of attorney, which is upon the back of the certificate, either leaving the form in its blank condition or filling up the blank with the name of the transferee, the certificate so endorsed is delivered to the transferee, and taken by him to the office of the company where it is delivered up for a new certificate in the name of the transferee, and such transferee is enrolled upon the books of the corporation as a stockholder. One becomes a stockholder from the time of the transfer of the certificate, but he secures full protection as a stockholder by having his name enrolled upon the books as a stockholder, for as we have seen, a corporation looks to its books to determine who are its stockholders. Before such enrollment one might be entitled to notices, dividends, etc., but he would not be fully protected in receiving them.

One who purchases stock expecting to resell it, does not always have himself entered upon the books as a stockholder, but the certificate, endorsed in blank, may pass through many hands without any record being made of its changing ownership. Thus if a certificate is made out to William Brooks, he could sign the indorsed power of attorney in blank, so that the transferee could fill in his name or not as he chose, such transferee could resell to A., and A. to B., and B. to C., by simple delivery of the same certificate so signed in blank by William Brooks, and the last purchaser could then fill out the form in his name and take the certificate to the office of the company and surrender it for a new certificate in his name.

When an old certificate is taken up it should be cancelled by the secretary, by perforating it and writ-

ing "Cancelled" across it. This old certificate should then be pasted on the underside of the stub to which it was originally attached. It should never be reissued.

The secretary or transfer clerk should assure himself of the genuineness of the signature of the transferor. He should completely fill out the new certificate. He should have the assignee sign the receipt upon the stub, where possible. He should not issue a new certificate except upon surrender of the old. If lost, he should require a bond, and for his complete protection should in case of lost certificates act only upon the resolution of the directors authorizing him to issue a duplicate.

Sec. 68. BY-LAWS AND REGULATIONS RESTRICTING TRANSFER. No by-law may be made restricting the transfer of stock without the consent of all the stockholders. But stockholders may agree among themselves that transfer of stock shall be subject to certain restrictions.

The stockholder has a right to transfer his stock. Any by-law passed to take from him this right is unreasonable and void. But a stockholder may agree that he will not sell his shares for a certain time or will first offer his shares to other stockholders of the corporation, or to the corporation.

Sec. 69. RIGHTS OF TRANSFEREE OF STOCK SOLD WITHOUT AUTHORITY. If a holder of shares of stock places the certificate in the hands of another, properly indorsed for transfer, a purchaser may assume that such holder has authority to sell, but the owner

of a certificate cannot be deprived of his rights through another's forgery, where he has done nothing to estop him to set up the forgery.

A party who owns a certificate of stock ought not to place it in the power of another to dispose of it as the apparent owner, unless he is fully confident of that other's honesty or carefulness, or his financial responsibility. For it is held by most courts that if one deposits with another a certificate of stock so endorsed that it may be transferred by delivery, he puts it in that other's power to represent himself as the owner or as one who has authority to sell. Certificates of stock, properly endorsed by the party recited therein as the owner, often pass from hand to hand, and one who holds such a certificate has documentary evidence of his title to the stock, or at least his authority to sell the stock.

If it is necessary for one who secures possession of a certificate not his own to forge the name of the owner upon the blank on the back, then the true owner loses nothing and the purchaser from such forger acquires no rights except against the forger. One cannot be deprived of his property by the forgery of another when he has not done anything which estops him to set up the forgery.

If a forged certificate is sold to an innocent purchaser for value, who takes it to the office of the company and has a new certificate issued in its stead, the holder of the new certificate is not thereby made a stockholder and has no rights against the corporation, for he has acted upon no representations made by the corporation. But if such new certificate is sold, the purchaser thereof acquires rights

against the corporation, for he has acted upon the representations made in this certificate by the corporation that the party from whom he purchased was the owner of shares and he may compel the company to recognize him as a stockholder if it has shares or may acquire them to issue to him; but if it does not have and can not acquire such shares it is then liable to him for his damages. But the shares of the original owner whose name was forged can not be claimed by the party damaged.

Thus, let us suppose that A. owns a share of stock in the M. corporation, and possesses Certificate No. 50 made out in his name, as evidence of that fact. He places it in the hands of B. his private secretary, with his signature to the blank assignment and power of attorney. B. represents to C. that A. desires to sell the stock and C. acquires the certificate, and fills in his name above A.'s signature. Here A. is estopped to set up his signature against C. Suppose, however, B. had forged A.'s name to the blank assignment. In that event C. could take no right superior to A.'s for A. has done nothing to estop him to set up his forgery.[11b]

Sec. 70. LIABILITIES OF TRANSFEREE TO CORPORATION. A transferee is liable for unpaid subscriptions unless the corporation by recitals or representations, on which the transferee relied, that the stock was paid, is estopped to claim it is unpaid.

The general rule is that one who buys stock on which the subscription is not called is liable to the corporation for the unpaid subscription; but if the certificate recites that the stock is paid, a purchaser

11b. Chicago Edison Co. v. Fay, 164 Ill. 323.

in good faith can rely upon that recital, as against the corporation. One of the purposes of such recital is to aid transfer, and the corporation cannot deny such recital upon which the purchaser relies. So if the certificate recites that all stock is non-assessable, that is binding on the corporation.

Sec. 71. LIABILITY OF TRANSFEREE TO CREDITORS OF THE CORPORATION. A transferee of stock is liable for the benefit of creditors of the corporation for the unpaid amount if he has knowledge that the stock is unpaid.

If a corporation becomes insolvent, one of its assets is the amount due on unpaid subscriptions. Are purchasers of stock from the subscriber liable at the suit of the creditors in such event? If when they purchase they know they are purchasing unpaid stock, even though it is recited in the certificate that it is paid, they are liable according to the law in many states. In a recent Illinois case the rule is laid down that an assignee of stock is bound to know that it is unpaid if from the circumstances, a reasonable man would have concluded the stock had never been paid in, as for instance where he purchases stock from the subscribers to a highly capitalized concern which he knows to have no tangible assets.

The recitals in the certificate that the stock is paid are binding upon the corporation, but not upon creditors of the corporation, and they can hold the holder of such certificate, regardless of such recital.

If stock has been paid in property, we have heretofore noted that if the property was fraudulently

valued, or, in some states, overvalued without fraud, the transaction may, on the insolvency of the corporation, be set aside and the subscriber of the stock held for the par value of the stock so far as necessary to pay the debts of the corporation. The assignee of such subscriber may likewise be held where he purchased with real or constructive knowledge of the circumstances.

Thus in one case a corporation was organized with a capital stock of $1,000,000. The directors agreed to receive and did receive a worthless patent in full payment for the stock subscribed by and issued to one Johnson to the extent of $998,000. Johnson's certificate read that this stock was "fully paid and non-assessable." He transferred his stock and assigned his certificate to one Rutan. Thereafter the corporation became insolvent and an attempt was made by one of the creditors to compel Rutan to pay the debt. The concern never had any tangible assets, as Rutan knew. The court held him responsible for the corporate indebtedness, saying, "It therefore appeared to have a paid up capital of $1,000,000 in money or property, and was possessed of nothing but the interest in the patent. It is not conceivable that a person of ordinary intelligence and prudence, buying shares of stock in such a corporation, would not become advised as to what property the corporation had." [12]

If stock is bought on the open market, the circumstances would usually be such that there was no knowledge of fraudulent over-valuation.

12. Garden City Sand Co. v. Crematory Co., 205 Ill. 42.

Sec. 72. LIABILITY OF TRANSFEROR TO TRANSFEREE. The transferor of shares impliedly warrants that the stock is genuine, that he has good title, unencumbered, and with right to transfer. If a further warranty is claimed it must be shown to have been expressly made.

The doctrine of *caveat emptor* applies in sales of stock beyond a few implied warranties, which are above recited. If the transferee desires further protection, he must exact express warranties. These would consist of any statement of fact made prior to or during the sale for the purpose and with the effect of inducing it, whether known to be false or not. But mere predictions and opinions do not constitute warranties. The vendor of stock would also be liable to his transferee for fraudulent statements of fact, that is, statements known to be false. The rules discussed concerning fraud in subscriptions are applicable in respect to sales by a stockholder. Defense could be made and rescission granted under the same circumstances.

CHAPTER 11.

DIVIDENDS.

Sec. 73. DEFINITION AND KINDS. Dividends are the funds or the property set aside by a declaration of directors for payment to stockholders as profits earned upon the stock.

A corporation is organized for purposes of profit to its stockholders. All profit is ultimately to go to them. It comes to them by way of *dividends*. Stockholders are not entitled to a division of the profits except upon a *declaration of a dividend* out of such profits.

Dividends are payable out of profits. It is improper to declare dividends where no profits have been made, and illegal where the corporation is insolvent, and in such case they may be recovered back, for their payment is a fraud on creditors.

There are the following kinds of dividends: First, the ordinary money dividend, which is declared in the vast majority of instances. Second, a script dividend, which is a dividend of certificates usually issued to anticipate the conversion of property now representing profits into cash at a later date. These certificates set forth the rights of the holder. Third, a stock dividend, or a dividend of the stock of the corporation, virtually representing a sale of unissued stock in return for the accumulated profits. A cor-

poration would of course have to have unissued stock which it could issue without exceeding its capitalization in order to declare such a dividend.

Sec. 74. DECLARATION OF DIVIDENDS WITHIN DISCRETION OF DIRECTORS. The declaration of dividends is within the discretion of the directors. But if there is a palpable or fraudulent abuse of such discretion a court may compel a declaration.

The directors have a wide discretion as to whether or not to declare dividends. Even though profits have been made still a court of equity will not at the instance of a stockholder compel the declaration of a dividend unless there is very clear evidence that the refusal on the part of the directors is in bad faith. To hold otherwise would be to give to the stockholders the power through court action to declare dividends. Yet, after all, the purpose of incorporation is to yield profit, and this ultimate purpose cannot be defeated or unduly hindered. The stockholders are the real owners of the business and the directors are trustees for them, and therefore a court of equity in a proper case will compel the declaration of dividends.

Sec. 75. PAYMENT OF DIVIDENDS. Dividends are payable at the time and place stated in the declaration. If not paid in accordance with the declaration the stockholder may sue as upon a debt due him.

After a dividend is declared it becomes a debt maturing at the time stated in the declaration. If not paid at that time the stockholder can sue as upon any other debt. The declaration may state the place

at which the dividend is payable, provided it is not unreasonable and oppressive.

Sec. 76. WHO ENTITLED TO DIVIDENDS. Dividends are payable to those who are stockholders at the time of the declaration. A transferee of stock after the declaration of the dividend has no right to an unpaid dividend, though its time of payment is after the transfer.

If a declaration of a dividend is made in January, payable in March, and in February a stockholder transfers his stock, is his transferee entitled to the dividend? It is settled that he is not. The dividend becomes payable to the stockholder who is such at the time of declaration, regardless of the question who shall own it when the dividend is payable or paid.

Sec. 77. DIVIDENDS UPON PREFERRED STOCK. Dividends must, as a usual rule, be declared upon preferred stock if there are profits for the current year out of which they may be paid.

The idea underlying the issuance of preferred stock is that the preferred shareholder shall have an investment on which he can rely for regular returns if the profits permit. Consequently the payment of dividends on preferred stock is not so largely within the discretion of the directors as in case of common stock. Yet undoubtedly they have some discretion. In considering whether there are profits, all the current expenses and indebtedness of the corporation must be deducted, and an item for depreciation should be included.

PART III.

THE DIRECTORS AND OFFICERS OF A CORPORATION.

CHAPTER 12.

DIRECTORS.

A. The Function and Composition of the Directorate.

Sec. 78. THE DIRECTORATE DEFINED. The directorate is the body elected by the stockholders to govern and manage the affairs of the corporation.

We have seen how stock passes readily from owner to owner and that one of the objects of incorporation is to permit the free transfer of shares; and furthermore we know how the stock of a corporation may be divided among many owners and may come into the hands of indiscreet, perhaps malicious persons, and for these and other reasons it becomes desirable to put the management of the corporation into the hands of some permanent board whose members may be chosen for their known executive and general business ability; hence it has become a universal custom to elect a governing committee or board, which is usually called a board of directors or sometimes, board of managers.

This directorate has the immediate government of the corporation in its hands. It is a council to

which is given the conduct of affairs while the stockholders go about their various concerns. It is elected by, and answerable to, and the representative of, the stockholders who are the real owners. Yet by the creation of this board, the stockholders deprive themselves of the power to have an immediate voice in the management of the corporation.

The directors must act as a board. Their power is exercisable in their collective capacity; and they must attend in person. They cannot delegate their discretionary duties. It is not necessary, however, that every director be present, for a majority (unless some other number is specially provided) constitutes a quorum for the transaction of business.

Sec. 79. QUALIFICATIONS FOR MEMBERSHIP IN THE BOARD. The director must usually be a stockholder. By law in some states he must be a resident of the state. The by-laws should specifically provide the qualifications.

By-laws usually provide that a director must be a stockholder. If there is no statutory prohibition, they may provide that he need not be a stockholder and this is sometimes, but not usually, done. A provision is often made that if during the tenure of his office he ceases to be a stockholder, it shall amount to a resignation by him.

The by-laws should, and usually do, set out in detail his qualifications.

Sec. 80. ELECTION OF DIRECTORS. Directors are elected by the stockholders acting in person or by proxy at a regular stockholders' meeting. The legality of an election may be tested in the courts.

The stockholders in meeting assembled elect the directors. They may vote in person or by proxy and may cumulate their vote as heretofore explained.

Usually there is an election of directors at the annual meeting. The terms of office of the various directors need not expire contemporaneously. Often the board of directors is composed of directors whose terms of office expire relatively after the manner of the terms of the United States Senators, so that the board is never completely renewed at one time. In the smaller corporations there is usually no need for such a provision.

If an election of directors is illegal, recourse may be had to the civil courts to contest it. The court will in this way prevent usurpation of office and will protect the rights of minority stockholders.

If no election is had at the appointed time the offices do not become vacant, but those in office continue to hold. This is indeed usually provided for in the by-laws which state that such directors shall hold office "until their successors have been elected and qualified."

Vacancies occurring by resignation, death or removal can only be filled by the stockholders, unless the by-laws give the directors power to fill vacancies.

Sec. 81. RIGHT TO REMOVE DIRECTOR DURING TERM. The stockholders may remove a director for serious misbehavior during his term. This right is called the right of amotion.

Aside from the provisions of statute or by-law there is a right in the stockholders to remove any director who seriously offends against the law of the land or the duties of his office. If he is charged with having committed a crime which does not directly touch and concern his office, he cannot be removed except he has been found guilty in a court of law. If the charge is that he has been unfaithful in his official duties, he is entitled to a regular trial by the corporation, to know beforehand the specific charge against him, and have counsel in his defense.

B. The Responsibilities and Rights of the Directors.

Sec. 82. THE DIRECTOR'S RESPONSIBILITY TO THE CORPORATION. The director is liable to the corporation for any damage occasioned by his participation in ultra vires acts, his culpable negligence, or purposeful injury by him.

If it is alleged that a director has wrought injury to the corporation, is he responsible in damages? This would depend. His office is one of large discretion. Because in the exercise of that discretion he has done something that another person feels that he would not have done, he cannot be held responsible. For mere timidity in entering into ventures where it is now thought the corporation would have made a profit he is not liable.

If, however, he has been palpably negligent in guarding the welfare of the corporation he may be liable for damages directly traceable to such negligence. So in cases, if he acts as no prudent man would have acted and thereby brings disaster upon the corporation he is liable. In a New York case, directors of a savings bank were held responsible because they had erected a large costly office building when the bank was in a failing condition, although it was admitted they had had the good of the corporation in mind in such action.[13] Directors must use a fair degree of prudence.

A fortiori if a director maliciously injures a corporation he is liable.

So if he commits any *ultra vires* act, knowing it to be *ultra vires,* or even if as a reasonably prudent man he should have known, he is responsible. As where, for instance, he makes the corporation liable on an accommodation paper executed to oblige a friend and which has now come into the hands of an innocent purchaser.

Sec. 83. LIABILITY OF DIRECTOR TO THIRD PERSONS. A director acting as such may become responsible to third persons, by reason of making false reports, declaring dividends wrongfully, etc.

If a director misuses his office to the injury of creditors or other persons, he is personally liable for the damage caused. Thus a creditor might hold him for using the funds out of which debts should be paid, for other purposes, as by declaring a div-

13. Hun v. Cary, 85 N. Y. 65.

idend when the corporation is insolvent. Or if he makes false reports to give the corporation a standing it is not entitled to and to secure credit the corporation could not otherwise have obtained, a creditor who was meant to act on such report and who did act upon it, could hold him personally.

By statute in various states it is set out how a director may become liable in different ways to a corporation.

Sec. 84. RIGHT OF DIRECTORS TO PROFIT BY THE RELATIONSHIP. The directors occupy a relation of strictest trust, and cannot use the position for purposes of secret profit, or to enter into unfair contracts, and any contract made with a director, whether fair or not, secured by his own vote or unfair influence is voidable. A director cannot vote himself a salary.

A director is in a position of trust. He occupies the office by virtue of a confidence reposed in him that as a representative he will guard the interests of those whom he represents. He cannot use the position for purposes of secret profit for that is not the purpose for which he was placed there. Accordingly he cannot sell to himself or buy of himself, vote himself a salary, make a commission, or in any other way oppose his interests to those of the corporation except upon full consent of all the stockholders. If he contracts with the corporation and his own vote was necessary to secure the contract, it is voidable at the suit of non-assenting stockholders, regardless of whether it was fair or not. If the vote of the director was not necessary, then he may make a binding contract with the corporation as to sell to it, buy from it, loan it money, etc. Yet even

in that case the contract must be fair. If not fair it may be avoided at the suit of dissenting stockholders provided they act with reasonable promptness.

Directors are not entitled to a salary in the absence of an express agreement by the corporation with them to that end. And directors have no power to take the profits of the corporation by way of salaries to them by their own vote. As a matter of fact directors often serve without salaries, but sometimes are allowed a *per diem* for attendance at meetings, etc.

C. Powers of Directorate.

Sec. 85. VARIOUS POWERS OF DIRECTORATE CONSIDERED. The directorate has the power to do all those things incidental to the management of the corporation, employing the agents, selling or mortgaging the property, issuing negotiable paper, etc.

As the directors constitute the board of managers, they have as a board very broad powers and can do everything that falls within the regular management of the corporation. They can determine the policies of the company, proceeding cautiously or more boldly, as their judgment dictates, retrenching here and extending there, and doing all things that properly fall within the management of the business. They cannot change the objects of the corporation, increase or decrease its capital stock, or carry on acts outside the scope of the corporate charter. But as long as they keep within the bounds provided by the charter they may do practically whatever the corporation may do.

Thus, they may borrow money for ordinary corporate purposes, and may authorize the issue of negotiable paper and the execution of mortgages upon the property of the corporation. They may hire the agents and officers to conduct the company's business, and fix the salaries of such agents and officers. They may sell the corporate real estate, buy real estate, and execute leases. They may make an assignment for the benefit of creditors when the corporation becomes insolvent.

Here are a few things they may not do: At the common law, and now, in some of the states, they cannot make the by-laws (but in some states this has been conferred on the directors); they have no power to release stock liability incurred by subscription; they have no power to sell out the business, or sell out all the property of the corporation for the purpose of stopping the business; and they have no power to do anything which is *ultra vires*.

D. Directors' Meetings.

Sec. 86. IN GENERAL. Directors must act in meetings. These may be fixed to occur regularly, as once a month, or they be held at special intervals.

Directors hold regular and special meetings. Ordinarily their regular meetings occur at more frequent intervals than those of stockholders. There is an annual meeting for the election of officers, and this usually follows immediately after the annual stockholders' meeting at which the directors or some of them have been elected. Then the by-laws provide in most instances for monthly meetings. When

there is no business to be performed by the directors, they may not come together at such monthly meetings, and the secretary should then simply enter upon the minutes that there being no quorum present, the meeting stood adjourned.

The by-laws usually provide that the meetings are to be held at a certain time or place. This time and place cannot be unreasonable.

The directors must act as a board, and thus their meetings are highly important. Any action taken by the directors, as such, without calling a meeting is invalid, but it may be ratified at subsequent meetings and thus the defect be cured.

Special meetings may be called as provided in the by-laws, or if there is no provision then by the president, or they may be held by common consent of the directors themselves.

A majority of the directors present constitute a quorum unless it is otherwise provided.

Much that has been said in reference to the manner of conducting stockholders' meetings, the legal value of the minutes, etc., is applicable here and need not be repeated.

Sec. 87. METHOD OF TRANSACTING BUSINESS AT DIRECTORS' MEETING. The directors transact business by voting and passing resolutions. Any order of business may be adopted which is found convenient.

The motions and resolutions, carried by majority vote, constitute the business done by the directors. A quorum must be present, else there cannot be any business performed. If such quorum is present, a majority can carry motions. When stockholders vote, one stockholder may be able to carry a vote

against many stockholders because he owns more stock and his voting power is determined by his ownership of stock. But directors vote as man and man. Each director, no matter what his ownership of stock, or whether he owns any stock, has as much power as any other director. Directors are elected on their reputation for discretion, business acumen and similar qualities.

The by-laws may set forth the order of business, but even then such a provision is more advisory than mandatory. The directors may consult their own convenience in transacting the business of the meeting.

Sec. 88. MINUTES. The secretary should make full and correct minutes of the meeting. These become the evidence of what is transacted.

The secretary of the corporation should attend and should carefully and regularly keep the minutes. A form of minutes is set out in the Appendix.

CHAPTER 13.

THE ADMINISTRATIVE OFFICERS OF THE CORPORATION.

Sec. 89. INTRODUCTORY. The ordinary executive officers of the corporation are the president, one or more vice-presidents, a secretary and treasurer. Officers are elected by the directors.

An executive officer of a corporation is a person who is elected by the directors to preside over and administer the affairs of the corporation, or some department thereof, under the general supervision of the directors. There are certain officers which we expect every corporation to have: The president of the board of directors, vice-president, secretary, and treasurer. Besides these executive officers there may be other officers in any particular corporation, as, for instance, that of chairman of the board, or of general manager, or auditor. In addition to these offices, there may be, of course, many positions of more or less importance, some of which are a sort of a division of an office and the duties attaching to them are ministerial rather than of a discretionary or executive nature. Thus, we have transfer clerks, general sales agents, accountants, bookkeepers, stenographers, etc.

The officers are elected by the directors. Usually they are elected to serve for a certain time, as, one year.

We will now consider in some detail the duties of the usual officers.

Sec. 90. THE PRESIDENT. The president is elected by the directors and his duty is to preside at meetings of the directors and to pursue such other activities as are prescribed for him in a particular case.

The duty of the president is to preside at the meeting of the directors, and to perform the duties that are imposed on him by the by-laws or otherwise. He is often given the power of a general manager of the corporation. As such general manager, he would have quite broad implied powers, namely, all of those powers which we would expect to find, because we customarily do find them, in the general manager of such a business. The president may usually employ the agents and servants of the corporation and in general oversee the carrying on of its regular business. He cannot, of course, bind the corporation upon any contract which the corporation has no power to make, and if any unusual contract is to be made by him, such as the purchase of land, special authority empowering him should be sought. The notes of a corporation are usually signed by its president in the absence of stipulations to the contrary.

The duties and powers of the president ought to be set out at some length in the by-laws, yet in any case parties dealing with the president upon some ordinary corporate matter are concerned rather with the apparent authority of the president, than that stated in the by-laws. As in the case of any general agent, he might seem from his position to have quite

larger powers than those formally conferred upon him.

In some corporations he has few active duties to perform and his position carries with it little authority to represent the corporation.

Sec. 91. THE VICE-PRESIDENT. The vice-president is an officer elected by the directors for the purpose of serving in the place of the president when that official is absent, and he is often given many other duties.

The powers of a vice-president must be sought in any particular case. He must preside at meetings of the directors where the president is absent; but what his particular powers shall be beyond this depends upon the facts in each case. Sometimes there are in large corporations a number of vice-presidents, to each one of whom is assigned some particular line of work. Very often the position is simply honorary.

Sec. 92. THE SECRETARY. The secretary is the officer elected by the directors to record the minutes and keep the books of the company and to carry on ordinary secretarial duties.

The secretary must keep the books of the corporation containing the list of the stockholders, the minutes of the various meetings and so on, and usually also has charge of the seal of the corporation and affixes it to the contracts and attests the signature of the president. He has no implied power to bind the corporation by contract except as the cir-

cumstances in each particular case may give him such implied power.

The secretary must see to it that the various notices are given, the reports to the states made, etc. For this reason he should keep before him a list or calendar of things to be done. He should never depend upon his memory. By making up a calendar of this sort and keeping it before him daily, it becomes sure that he will overlook nothing. The duties of the secretary in respect to the transfer of stock, keeping the minutes, etc., are treated under those headings.

Sec. 93. THE TREASURER. The treasurer is an officer elected by the directors to take charge of the funds of the corporation and keep its fiscal accounts.

The treasurer of the corporation has the right to receive the funds payable to it, must keep account of those funds and must in general perform all of those duties which are ordinarily given to such an officer in any organization, corporate or otherwise. See the provisions in the by-laws in the Appendix.

Sec. 94. IN GENERAL. The above statements are very general in nature and the powers of any particular officer must be sought from the by-laws, the customs and all the facts in each particular instance.

The powers of any officer of a corporation are very largely governed by the particular facts in each case. Thus, the president of one corporation might have much broader powers than the president of another corporation from the fact that such powers had been granted him by by-law or from the fact that he had been invested with apparent au-

thority by the corporation to make particular contracts or to pursue a certain line of conduct. An agent, as we know, is presumed to have all of the authority which anyone acting under those same circumstances would be presumed by a reasonable man to have. It is true that he cannot have greater powers than the corporation could exercise under its charter. It is also true that if any particular or unusual acts are to be performed, there would not be any implied authority on his part to perform them, but the particular authority should be sought by the person acting with such officer. The powers of any officer of a corporation are governed largely by the usual rules of agency.

Sec. 95. EXECUTION OF CONTRACTS BY OFFICERS OF CORPORATION. The officers of a corporation should execute its contracts in the corporate name signed by them as officers. The seal should be affixed on all papers when required by the by-laws, or of solemn import, and on those contracts upon which whether executed by a corporation or a natural person the law requires a seal.

It is a rule of the law of agency that an agent to bind his principal and not to bind himself must contract in his principal's name. An officer of a corporation must bear this rule of law in mind. If he signs in his own name even though he describes himself after his signature as an officer he will bind himself. Thus if he signs his name "William Smith, President of A. B. Co.," this is hardly more than saying, "I am the president of the A. B. Company. I want to get some supplies for the corporation and if you will let me take them I will promise to pay

for them." Rather such officer should sign as follows:

THE A. B. COMPANY,
By William Smith,
President.

It is not necessary to state the officer's name in the body of the instrument. That is usual in contracts made by other principals than corporations, and in contracts made by corporations through other agents than its officers, but is not done so frequently where an officer signs a contract, because the corporation must act through some agent and that agent is usually an officer.

The by-laws sometimes provide how particular contracts shall be signed, and it is sometimes stated that contracts must be *attested* by the signature of the secretary and the seal of the corporation. In such a case the signature would be as follows:

Attest: THE A. B. COMPANY,
[L. S.] By William Smith,
JOHN WILLIAMS, Its President.
Secretary.

The old law used to be that a corporation spoke only by its seal, but one can readily see that such a doctrine must of necessity be departed from in these days. A corporation need not now affix a seal unless it is entering into a contract upon which the law requires a seal no matter who executes it. Such contracts (in many states) are deeds, mortgages, bonds and powers of attorney.

The by-laws may require the affixing of the seal in various instances besides those required by law.

The use of the seal is helpful also in this respect, that it raises a certain presumption as to the authority of the officer signing the contract, and accordingly it is usually fixed to any contract of an important or unusual nature. It is almost invariably placed on stock certificates.

Where instruments are drawn up in a formal way, the ending is usually in the shape of a "Testimonium Clause." The following is an example taken from an Illinois mortgage form:

In Testimony Whereof, The said Mortgagor hath hereunto caused its corporate seal to be affixed, and these presents to be signed by its ..... President, and attested by its ..... Secretary, this ..... day of ..... in the year of our Lord nineteen hundred and twelve.

.....

(Corporate Seal) By .....
Its President

Attest: .....
Secretary.

In instruments of informal kind, the signature is also informal.

Notes, checks, etc., have no testimonium clause.

PART IV.

CREDITORS OF A CORPORATION.

CHAPTER 14.

CORPORATE BONDS AND MORTGAGES.

Sec. 96. POWER OF CORPORATION TO ISSUE BONDS AND MORTGAGES. A private business corporation has implied power to borrow money and to that end may issue bonds to evidence the indebtedness and execute mortgages to secure it.

A corporation has the implied power to borrow the necessay funds to finance its legitimate projects. This power to borrow money includes the power to use those means whereby the borrowing may be accomplished, that is to say, the power to issue promissory notes, or bonds, whereby its obligation may be evidenced, and the power to execute mortgages upon its real or personal property whereby the obligation is supported. When a public or quasi public or municipal corporation issues bonds and mortgages, other questions may arise, for usually, either by a general statute or by the particular charter, the authority must in such case be specially conferred. But a private corporation has this power by implication.

Sec. 97. NEGOTIABILITY OF CORPORATE BONDS. If corporate bonds are drawn so as to contain all the requisites of negotiable paper, they are in effect promissory notes with the property of negotiability.

A bond in ordinary form is a promise of the corporation to pay at some future time a certain sum of money. It is an evidence of an indebtedness and a definite promise to pay the indebtedness. Negotiable instruments must contain certain elements such as certainty of sum payable, certainty of the time of payment, words of negotiability, etc., and there must not be any conditional stipulations. If a bond of a corporation is drawn in such form, it is negotiable. It is in reality a promissory note, but it differs from the ordinary form in that it is a part of a series, the units of which may be held by various parties, the whole series being secured by a mortgage upon the property of the corporation.

As bonds may be negotiable, an innocent purchaser for value takes the same sort of title to them which he would have in the case of the purchase of any negotiable paper. He must, however, take notice of the recitals in the bond. If he knows that the issue was fraudulent, or an over issue, or any other fact that would nullify the issue, he gets a defective title.

Sec. 98. FORM OF BONDS. Bonds are issued in two general forms, (a) registered bonds and (b) unregistered or coupon bonds.

A coupon bond is a bond payable to bearer, or to some one or his order, and has attached to it, interest coupons for the installments of interest as the

installments fall due. These coupons may be clipped off and sold separately as promissory notes. Coupon bonds are transferable by mere delivery and are intended to be negotiable. A registered bond is a bond transferable only by registering the name of the transferee on the books of the corporation, and its negotiability is temporarily withdrawn, as it is not payable to any one's order or to bearer.

The bond usually recites that it is one of an issue of a series of bonds numbered consecutively from some number to another, sets forth the denomination, amount of issue, security, etc. It refers to and describes the trust deed or mortgage.

Sec. 99. THE BOND SECURITY. The bond is usually secured by a mortgage upon the property of the corporation, which is usually in the form of a trust deed naming one or several trustees who hold the title for the benefit of the bondholders.

The bondholders of a corporation usually have their security by way of mortgage. This mortgage is in form a trust deed, that is to say a deed to a trustee, who shall hold upon the trusts stated in the deed. It is this security which makes the bond salable and each succeeding bondholder is safe if the security is ample.

Sec. 100. REMEDIES OF BONDHOLDERS. A holder of a bond or bond coupon which has fallen due can sue at law and obtain a judgment, or if there is default in the provision of the mortgage, the trustee can foreclose for the benefit of the bondholders.

A bondholder may sue in the court of law and obtain judgment as upon any other obligation which

has fallen due. He can not levy upon the property covered by the trust deed, but may levy on any other property belonging to the corporation.

The trustee may upon default bring an action to foreclose for the benefit of the bondholders. In such a case the property would probably be placed in the hands of a receiver.

Sec. 101. OTHER INDEBTEDNESS OF A CORPORATION. A corporation may issue and become liable on negotiable paper, secure the same by mortgage and have indebtedness after the manner of a natural person. Its property is subject to execution.

Assuming in a general way that a corporation is acting in the exercise of its charter activities, it may accomplish its results by issuing or endorsing notes, bills of exchange or other evidences of indebtedness; may accept bills of exchange; execute chattel and real estate mortgages; become indebted on open account; be subect to levy under execution or attachment; have its mortgages foreclosed; be made a bankrupt; and in general is subject to the same considerations in these respects as a natural person.

CHAPTER 15.

INSOLVENT CORPORATIONS.[14]

Sec. 102. DEFINITION. We may for our purposes define an insolvent corporation as one whose assets are insufficient to pay its liabilities, and which for that reason cannot meet its current expenses and maturing debts.

We are to consider in this chapter the rights of creditors of a corporation which is failing and cannot meet its financial obligations.

Sec. 103. THE TRUST FUND DOCTRINE. The property of an insolvent corporation is regarded as being held in trust for its creditors, but aside from the fact that creditors are always to be satisfied before the shareholders are entitled to a division of the assets the application of the doctrine is not entirely uniform.

There is a doctrine in corporation law, known as the "trust fund doctrine." Some courts are inclined to limit the application of the doctrine while others give it an extensive application. All the courts are agreed that the stockholders have no right to a division of the assets until creditors have been paid, whether such creditors have or not any security or lien. If one is a creditor he is entitled to his

14. In connection with this chapter see chapter 7.

rights as creditor, though he may be a stockholder or director.

This trust fund doctrine prevents a corporation from releasing subscribers, compromising with them, paying back to them their subscriptions, paying dividends when insolvent, issuing stock at less than par, etc., for in all of these issues the creditor is deprived of assets to which he should have access.

Sec. 104. RIGHT OF INSOLVENT CORPORATION TO PREFER CREDITORS. In many states, it is allowable for a corporation to prefer one creditor over another, and this preferred creditor may in some states, be also a stockholder, but not a director. But a preference of any creditor is an act of bankruptcy and usually avoidable by proceeding in apt time.

By the principles of the common law it was perfectly legal for an insolvent debtor to prefer one general creditor over another. If A.'s assets are $1,000 and he owes B., C. and D. each $1,000, none of whom has any security or lien, he may pay $1,000 to B., and C. and D. can not complain. They must wait until he acquires other assets. This applies to a corporation. But the question arises: suppose the preferred creditor is a stockholder? On principle, a preference should not be allowed, because the stockholders of a corporation are the real owners of a business, and a preference to a stockholder is in reality a preference by one to himself. But the fiction of the law that a corporation is a separate entity has often had results which while theoretically logical, are actually unjust. Some states allow a debtor to be preferred where he is also a stockholder.

But almost everywhere, a director cannot be preferred.

By our National Bankruptcy Law, preferences are acts of bankruptcy, that is, they are acts which give creditors grounds upon which to base a petition in bankruptcy, provided the debtor is proceeded against within four months from the time that the preference was given. Insolvency is a necessary element to this act of bankruptcy. A preference may also be set aside by the trustee in bankruptcy where the creditor to whom it was paid knew or had reasonable cause to know that preference was intended.

Sec. 105. RIGHT OF INSOLVENT CORPORATION TO MAKE A GENERAL ASSIGNMENT. A corporation may make a general assignment for the benefit of its creditors. But any dissenting creditor can by proceeding in the courts of bankruptcy have it set aside.

A corporation has power to make a general assignment of its assets to a trustee for the benefit of all its creditors. Our National Bankruptcy Law makes that, however, an act of bankruptcy, and voidable by any dissenting creditor.

Sec. 106. RIGHTS OF SECURED AND LIEN CREDITORS. A secured and lien creditor of an insolvent corporation is protected to the extent of his lien and security, except that some liens are dissolved by bankruptcy.

One who takes security for his debt at the time of its inception whether from an individual or a corporation is safe to the extent of the value of that security. It is immaterial whether or not the debtor

is insolvent even though insolvent when the security is taken. The same may be said of one who acquires any lien, except that liens which are acquired through legal proceedings (as a lien acquired through attachment or judgment) is dissolved by bankruptcy proceedings which are begun not later than four months after the lien is acquired.

Sec. 107. WHAT ARE ASSETS OF THE CORPORATION—STOCKHOLDERS' UNPAID LIABILITY. All species of property including debts owing the corporation constitute its assets and are collectible for the benefit of the creditors in a proper proceeding.

The creditors of a corporation may collect their debts out of the assets of whatsoever nature, whether tangible or intangible. In a court of equity, by creditor's bill, or otherwise, or in a court of bankruptcy, the creditors, or the trustee in bankruptcy for them, may proceed to the collection of assets. Among these assets are the claims against stockholders on their subscriptions. If a corporation is organized for $25,000.00 and this is all subscribed but only in part paid in, that which is not paid in may be collected upon the insolvency of the corporation for distribution among the creditors to the extent to which it is necessary to pay such creditors.

Sec. 108. REMEDIES OF CREDITORS OF INSOLVENT CORPORATION. Creditors of an insolvent corporation may file a petition in bankruptcy against it, or proceed in the state court under state statutes, for the

appointment of a receiver. And they have the usual remedies of any creditor against his debtor.

Aside from the usual remedies which a creditor has against his debtor for the collection of the debt, the creditors may put an insolvent corporation into bankruptcy whenever it commits an act of bankruptcy, and also under state statutes, they may proceed to have a receiver appointed and the corporation wound up, and in this manner they secure distribution of its assets among them.

PART V.

POWERS OF A CORPORATION.

CHAPTER 16.

GENERAL CONSIDERATION OF POWERS OF A CORPORATION.

Sec. 109. POWERS CLASSIFIED. INHERENT POWERS. Powers of a corporation may be classified as those powers which are inherent in corporate existence; express charter powers; and powers implied from express charter powers.

The powers inherent in corporate existence may be set up as follows: 1. Power to have a name; 2. Power to have a seal; 3. Power to make by-laws; 4. Power to have a board of directors; 5. Power to sue and be sued; 6. Power to receive, hold and grant. Every corporation has the above powers no matter what the purpose of its existence may be. In other words, whether it is a corporation organized to buy and sell drygoods or whether it is a corporation for some charitable purpose, it would have these powers unless in some particular case some of them had been denied. That is to say, these powers are inherent in the very existence of a corporation. Besides these powers it has the powers which are expressly conferred in the particular case and those powers which we reasonably imply therefrom.

Sec. 110. EXPRESS CHARTER POWERS. A corporation has all the powers set forth in its charter or certificate of incorporation which are not illegal or inconsistent with the public policy of the state. The charter should state definitely the express powers of the corporation.

The corporation has the express power which the charter or certificate of incorporation gives it. A corporation cannot have powers which are contrary to the laws or general public policy of the state even though an attempted grant of such powers should have been made by including them in the certificate of incorporation. Thus, if it is contrary to the law that a corporation should be organized for the purpose of dealing in real estate or of dealing in the shares of another corporation for the purpose of controlling that other corporation, a charter attempting to set out such powers would to that extent be void. The charter powers of a corporation should be definitely stated so that the purposes of incorporation are clear.[14a]

Sec. 111. IMPLIED CHARTER POWERS. A corporation has all such powers implied from its express charter powers as are necessary and reasonable for carrying into effect its express charter powers.

Although a corporation may be said to have (besides the inherent powers) only those powers given it by its charter, yet it is not necessary that all those powers be expressly stated. Many will be implied from the language used. We may, so to speak, "read

14a. See Appendix A, 2. (1) (2).

between the lines" to discover many powers possessed by a corporation. This is a necessary doctrine because it would be next to impossible to set forth all the powers in detail which a corporation shall have. Nor would any other doctrine accomplish any good end. If the charter sets forth the main objects of the corporation, the corporation should then be held to have all of those incidental powers necessary and convenient for carrying its express powers into execution. If a corporation is chartered for the purpose of manufacturing and selling automobiles it ought to be unnecessary to state that it shall have the power to own machinery for that purpose, or land upon which to erect its plant, or that it shall have power to issue catalogues, print letterheads, employ clerks, advertise its business, borrow money, sign checks and other negotiable paper, mortgage its property, and so on. And such is the law. All powers will be implied which are incidental to the main power expressly stated.

In this way a corporation may enter into activities which would if pursued for their own sake be foreign to the purposes of the corporation. This is illustrated by the following example: A corporation was organized for the purpose of buying and selling lumber. It became surety upon the bond of a building contractor upon the agreement by him to purchase all the lumber needed in a certain building from that corporation. When the corporation was sued for the breach of this bond, it defended that it was not organized for the purpose of signing bonds or becoming surety and therefore it could not be held responsible upon a contract thus unlawfully made by it. But the court held that as it had signed

this bond as an incidental means of extending its own legitimate business, that of selling lumber, it was a proper contract for it to make, and it was liable upon such contract.[15] Had this corporation gone upon some bond, as for instance, an appeal bond, for the purpose of earning a premium, the corporation would be attempting an activity beyond the scope of its charter no matter how profitable the bonding business might be if pursued by such corporation, because being a lumber company, it would not have the power to write bonds or become surety upon them either as a business or as an isolated transaction.[16]

What a corporation does which is not justified by its express charter powers must be purely incidental or merely as a reasonable and convenient means of carrying those powers into execution. The *benefit* to the corporation is immaterial. In one case a corporation organized to build and deal in sleeping cars laid out a town, owning the homes, constructing sewage, water and lighting systems. The court held that it had no power to do these things, they not being mentioned in the charter and being foreign to the business of building and selling sleeping cars.[16a]

15. Central Lumber Co. v. Kelter, 201 Ill. 503. See also, Kraft v. West Side Brew. Co., 219 Ill. 205.

16. Best Brewing Co. v. Klassen, 185 Ill. 37.

16a. People v. Pullman Car Co., 175 Ill. 125. Three justices, however, dissented, saying, in part, "We are not prepared to condemn [these things] [done] with the object of appealing to the better and more skillful workmen and securing and retaining them in its employment." This case illustrates the differences of opinion and difficulties attending this subject.

Sec. 112. NOTICE OF POWERS OF CORPORATION. Any party must take notice of the charter powers of a corporation and be bound by a notice of these powers, for they are a matter of public record.

Any party who deals with a corporation cannot claim that he did not know the charter powers of such corporation, for these are a matter of public record and he is bound by a constructive notice of such powers. Of the by-laws he may claim ignorance in many cases, where the corporation has permitted its agents to violate a by-law, or where the corporation has taken benefits of a contract made contrary to a by-law; but this cannot be said of charter powers.

Sec. 113. ENFORCEMENT OF CONTRACTS ULTRA VIRES. A contract made in excess of the power of the corporation is said to be "ultra vires" and cannot be enforced either by the corporation or the other party thereto so long as the contract is wholly executory, but where the benefits have been received under the contract the corporation or the other party so receiving them is held by many courts to be estopped to assert this defense. But in other jurisdictions the defense of ultra vires may be made even by a party who has received the benefit of the contracts; yet in such case the benefits must be returned or their reasonable value accounted for.

The subject of the powers of a corporation involves of course an inquiry as to the effect of attempted user of powers which the corporation does not have. If the agents of a corporation attempt to bind it upon a contract which it has no power to make what rights, if any, can arise upon such a

contract? If such a contract is wholly executory when the corporation or the other party fails or refuses to go on with it, the defense of excess of powers, or, as we say technically, the defense of *ultra vires* can be interposed. But the more difficult questions arise where the party who is attempting to assert the defense has received benefits under the contract. Many courts say that in such a case he will not be permitted to set up the defense. By his conduct he is estopped. But in other courts if the corporation sues the other party, or if the other party sues the corporation, the defense of *ultra vires* may be set up even though the party defending has received benefits under the contract. In such a case the benefits would have to be accounted for at their reasonable value.

This subject of *ultra vires* is a very extensive one and has been variously applied by the different courts, and even by the same courts, and it is not possible to go into an extensive treatment or give illustrations here, yet in a very general way it is believed that the statement here made is a correct statement of the law and will suffice for our purposes.

CHAPTER 17.

CERTAIN PARTICULAR CORPORATE POWERS CONSIDERED.

Sec. 114. POWER OF THE CORPORATION TO ACQUIRE AND HOLD REAL ESTATE. A corporation organized for any purpose has the right to own and hold as much real estate as is necessary and reasonable to enable it to pursue its objects.

Every corporation has the implied right to own as much property both personal and real as is required for the purpose of carrying out its charter powers. It is, of course, essential that every corporation, to pursue its objects, have a plant and its office and so on, and therefore it is never necessary to state in the charter that the corporation shall have the right to acquire and hold the necessary real estate, for these are incidental powers.

If a corporation which is organized for a legitimate purpose holds more than the necessary amount of property, it may be compelled to sell it at the suit of the state, but no person other than the state can question whether or not it is exceeding its powers in this regard.

Though a corporation may not by law acquire large property holdings for the mere purpose of renting them out, where that is not its charter power, still it is acting entirely within its power when it acquires such property to provide for its reasonable growth. Thus, the attorney-general of Illinois ques-

tioned the right of the Pullman Company to erect a large office building which it rented out to tenants. But the court found that it was only looking forward to reasonable growth, and could erect a building to provide for such reasonable growth though not then necessary, and that pending its own need of the place, it could rent to tenants. [17]

Sec. 115. POWER OF CORPORATION TO BORROW MONEY, MORTGAGE ITS PROPERTY, ETC. The corporation has an implied power to borrow money and as an incidental means thereto may mortgage its property, issue negotiable paper, etc.

It is the right of a private corporation to borrow money, though no express power has been given it to that end, and because it has this power to borrow money it follows that it has the power to give the necessary security by way of mortgage, so that such loan may be accomplished. Also it follows that it has the power to issue the evidences of its debt, namely negotiable or non-negotiable instruments, as bonds, promissory notes, etc.

Sec. 116. POWER OF CORPORATION TO LOAN MONEY. Unless a corporation is organized as a bank, it has no power to loan money for the mere purpose of making a loan.

As surplus earnings of a corporation are to be used for the payment of dividends, a corporation is held to have no right to make loans for mere incidental advantage, yet in proper cases where the

17. People v. Pullman's Palace Car Co., 175 Ill. 125.

money was being accumulated for the purposes of increasing equipment and so on, it would undoubtedly be the corporation's right to make short-term loans upon proper security.

Sec. 117. POWER OF CORPORATION TO SELL ITS PROPERTY. Assuming that there is no dissent among the stockholders, every corporation has the power to sell all of its property and discontinue business unless it is a public coporation.

While it is true that any dissenting stockholder can prevent the sale of the property of a going concern in the absence of some enabling statute which is being pursued, still it is true that when no such objection is made, any private corporation can sell its entire equipment and discontinue business. This is not true of public corporations, which can not sell their businesses except in compliance with various statutes passed to that end.

The charter of a corporation can not be sold by the corporation, as only the state can grant a charter, but the charter is as a matter of fact practically sold by having all of the stockholders sell their stock to the parties who desire to buy the corporation. These new parties thereupon, being all the stockholders, own the corporation.

Sec. 118. POWER OF CORPORATION TO ACQUIRE SHARES IN OTHER CORPORATIONS. A corporation has no power to acquire shares in other corporations for the mere purpose of being a shareholder unless authorized by its charter or a governing statute.

In some states it is allowable for a corporation to have a charter providing for the holding of shares in

other corporations. In other states it is considered against public policy to permit such a power. No corporation has this power unless given by its charter or by a general law. In any case, however, where it would be necessary for the protection of a corporation to acquire shares merely as property, as where it seized them upon attachment or execution, it would be acting legitimately. In such a case it would not be acquiring them in order to be a stockholder but merely to hold them as property.

Sec. 119. POWER OF CORPORATION TO ACQUIRE ITS OWN SHARES. A corporation has power to buy in its own shares when no harm is thereby done creditors.

If the purpose of a corporation is a proper one, and its exercise is not in fraud of the rights of creditors, a corporation may buy its own shares. Such stock is called treasury stock and may be re-issued. The same *certificates* however, should never be re-issued.

PART VI.

CHAPTER 18.

FOREIGN CORPORATIONS.

Sec. 120. DEFINITION AND GENERAL STATEMENT. A foreign corporation is a corporation incorporated under the laws of some state other than the state in which its rights are under consideration. A corporation has no rights outside of the state which incorporates it, except by comity and except in certain cases given under the Federal Constitution.

As a corporation is created by the laws of the state and therefrom derives its entire existence, it follows that it has no rights outside of the legislative jurisdiction of the state which created it. There are, it is true, some cases in which a corporation is entitled to enter other states because of provisions in the United States Constitution which will be noted later. It is also true that most states do not prevent corporations from entering, but permit them to come in through comity, providing, however, more or less drastic laws with which they must comply before they enter, unless they enter under the aforesaid provisions of the United States Constitution.

Sec. 121. COMMON PROVISIONS IN RESPECT TO FOREIGN CORPORATIONS. It is usually provided in

the various states that a corporation of another state must file certain papers and pay certain fees and take other steps before it shall have any right to do business.

All of the states have foreign corporation laws, some of which are quite drastic. These laws usually provide that a copy of the charter must be filed, certain fees must be paid, and a statement made and filed, setting forth where the principal office is to be located, an officer or representative on whom service of legal papers may be made, etc.

The penalty for not complying with this law is usually in the shape of a fine, and also a provision that the corporation shall have no right to sue upon contracts made or rights accruing before it had complied with the law.

Sec. 122. WHAT CONSTITUTES "DOING BUSINESS" IN ANOTHER STATE. These foreign corporation laws do not apply to a foreign corporation unless it is doing business within the jurisdiction within the meaning of the statute.

The statutes of the various states provide the penalties above mentioned in case a foreign corporation enters its boundaries to do business. It then becomes of great importance to determine whether a corporation which has not complied with such law was doing business within the meaning of the statute. Thus the A. & B. Manufacturing Co., organized under the laws of New York, starts suit in Illinois against a defendant residing in Illinois. It has not complied with the foreign corporation law of Illinois.

That fact is set up by way of defense. The corporation then replies that the defense is not good because it was not and is not doing business in Illinois.

It is well decided that single isolated transactions do not constitute doing business. Buying real estate, being grantor or grantee in a mortgage, holding stockholders' meetings, selling shares, are all examples of what is not "doing business." So sending a traveling salesman into a state to receive orders, and transmit them to the home office where they are accepted and filled, is not "doing business."

Doing business then consists in practically coming into the state for the purpose of conducting in whole or part, the business of the company. As where branch offices are opened up at which contracts are closed, goods sold, etc.

SEC. 123. WHEN FOREIGN CORPORATION HAS CONSTITUTIONAL RIGHT TO ENTER OTHER STATES. Any corporation which is engaging in interstate commerce or which is employed by the United States may enter any other state in the Union for the purpose of carrying on such business.

The United States Constitution gives to the Federal government all rights over interstate commerce and no state can pass any law or take any action which will interfere in any way with interstate commerce unless the Federal Congress gives it that right. So any corporation which is engaged in interstate commerce may enter any other state for the purpose of carrying on that business and can not be restrained by the foreign corporation law of any

state. Also, if it is engaged in the business of the United States, it may enter any state in order to carry on such business.

Interstate commerce consists in the commercial intercourse of people of one state with those of another. It includes the carrying of passengers from state to state, the transmission of language by telegraph, telephone, mail or otherwise, the shipping of goods from state to state. If goods are ordered by a resident of Illinois from a corporation doing business in Indiana, to be shipped to the buyer in Illinois, this is interstate commerce, and the Indiana corporation need not comply with the Illinois Foreign Corporation Law. If the buyer in Illinois refuses to pay, the Indiana Corporation may enter Illinois and bring suit without complying with the foreign corporation law.

Sec. 124. SUIT AGAINST FOREIGN CORPORATIONS. Any foreign corporation can be sued in any state in which it is doing business whether it has complied with the foreign corporation law or not, and service may be obtained by serving any officer who can be found in that jurisdiction or by seizing any property that there may be found.

A corporation may be sued either in the state in which it is organized or in any state into which it has gone for the purpose of doing business. If it is not doing business within a state it can not be sued in such state no matter though its officers may be found there. Thus, if a corporation is organized in the state of New York and does not do business in the state of Illinois and has no property in the state of Illinois, it can not be sued in the state of Illinois,

even though its officers live there or are there temporarily and service can be had upon them. Such service is not good and will be quashed. If a corporation has entered a state to do business therein, it may be sued in such state whether or not it has complied with the foreign corporation law, but it cannot bring suit in many states where that is made the penalty for non-compliance.

PART VII.

CHAPTER 19.

TRUSTS AND MONOPLIES.

Sec. 125. A "TRUST" DEFINED. The term "trust" is used in corporation law (among other uses) to denote that stockholders of different corporations have assigned their stock in trust to a central body of trustees who shall hold such stock for a certain period to vote it for the stockholders in order to give a common control of such corporations and prevent competition. It is illegal. Such term has also by popular usage come to denote any large corporation of monopolistic tendencies.

The term "trust" is by no means confined to a place in the law of corporations. In fact it has, perhaps, its smallest application there. Our law permits the division of title into two parts—the legal title and the beneficial title. These are oftenest in the same person, as where one for his own use has titles to lands or chattels of any sort. But the legal title may be in one in trust for another, or charged with trusts for another. Thus one may by deed or will give his land to a natural person or a corporation in trust for another, thereby putting the legal title and control of such land in one, and the right to its benefits in another; ultimately the legal title must also come to that other unless the trust is a mere

charge upon the property for a limited period. This disposition of property is of ancient sanction and is not only legal but, in many cases, highly commendable so long as it is opposed to no other rule of law. One may bestow shares of stock in trust the same as any other species of property. For instance he may in his will bequeath certain shares of stock to his brother to hold in trust for his son until his son becomes of age. Thus we see that the term "trust" in its large sense holds no invidious meaning. Corporations, indeed, as every one knows, are often chartered to act as trustees.

In order to avoid competition among rival concerns, and put them under a common control whereby output and prices could be regulated, it was considered that the result would be accomplished if a central body of trustees should be created to whom all the shareholders should transfer their shares for a certain period, such trustees to hold such shares in trust for the stockholders, to pay the dividends to them, and after a period to re-transfer to them, such stockholders to be given in return trust certificates, which should serve them instead of the assigned stock certificate. In this way the central trustees holding the legal title to the stock upon the trusts mentioned could vote such stock and thereby control the directorate and the corporation. A corporation whose stockholders were subject to any such an arrangement was said to be "in the trust." Such trust might or might not constitute a monopoly or virtual monopoly. But in any case whether large or small and no matter on what lines conducted it is illegal. Its purpose is to destroy competition and control output and prices. It has also been declared to be

illegal because it puts the control of the corporation out of the hand of those who ought to control it.[18]

Sec. 126. CONSOLIDATION OF CORPORATIONS. Corporations may consolidate either by a reorganization after a dissolution of each of them or by proceeding according to the statute which provides for consolidation. A consolidation of many corporations into one is not illegal except where a monopoly is thereby created or trade unreasonably restrained.

Recent years have seen the rise of large corporations whose operations are national or international in extent. Many of these have arisen by the consolidation of many businesses, incorporated or unincorporated. There is no illegality in the mere fact that a corporation is *large* or that it is the result of a consolidation of many corporations. The statutes, indeed, provide the means whereby consolidation may be brought about, and in that sense may be said to encourage it. Such corporations though the result of a desire to decrease the cost of independent operation and to avoid the competition otherwise entailed are no more illegal than when two grocers who have operated independently decide to become partners. They become illegal when they result in monopoly or are in unreasonable restraint of trade, as we discuss in the next section.

Sec. 127. CORPORATIONS FORMED TO MONOPOLIZE OR RESTRAIN TRADE. A corporation which is formed for or brings about monopoly or which unrea-

18. See Sec. 55, as to voting trusts which are legal.

sonably restrains trade and agreements to monopolize or unreasonably restrain trade are illegal.

Monopolies and agreements to unreasonably restrain trade are against public policy by the principles of the common law and by numerous statutes passed for that purpose. The term "monopoly" signifies that there is a control of all or virtually all of the production or output of a certain line of trade. There must be this control or there is no monopoly. Thus a corporation might have all the trade in the country because of the fact that no other person or corporation was successfully carrying on that trade. Monopoly signifies then, that all of the forces of output have in some way been controlled or purchased. An agreement in unreasonable restraint of trade is illegal. It has always been legal to restrain trade to a reasonable extent, as where one person sells his business to another and agrees not to compete within a certain territory. But any agreement between parties which has for its purpose control of output and stifling of competition is illegal.

The various states have statutes which provide for prosecution and even dissolution of corporations which are operating as monopolies or in restraint of trade. The United States passed a law in 1890 known as the "Sherman Law" or "Sherman Anti-Trust Law," under which many well known cases have been prosecuted.

PART VIII.

CHAPTER 20.

DISSOLUTION AND WINDING UP OF CORPORATIONS.

Sec. 128. WAYS IN WHICH A CORPORATION MAY BE DISSOLVED. A corporation may be dissolved (a) by expiration of time stated in charter, (b) by act of the legislature, (c) by judicial decree, (d) by voluntary act of its stockholders, (e) by non-user.

Corporations organized by special acts in former times have usually perpetual life. No time is stated for their expiration. Usually now under the general statutes, a corporation can not be organized for more than a certain period of time. In Illinois, for instance, the time is ninety-nine years. At the end of such time corporate existence may be renewed by complying with the statute.

The legislature now reserves the right to alter, amend or repeal charters. If it exercises such power it must do so without violating the obligation of contracts (other than those included in the charter itself) and without depriving the corporation of its property without due process of law. The general corporation laws of the state are often changed with the effect of altering to some extent the charters obtained under them, but this is as far as legislation goes. Any law repealing or altering charters

would have to be general. It could not pick out certain corporations and not affect others of the same kind.

The courts may in proper cases dissolve a corporation. The statute usually gives the right to the attorney general to proceed against a corporation for non-use of its charter, or for violation thereof, and have the charter revoked. The creditors, also, of an insolvent corporation may proceed against it for the purpose of having its assets distributed and its existence ended. Proceedings in bankruptcy, however, do not in theory, however it may be in fact, dissolve a corporation. A bankrupt corporation is entitled to its discharge in bankruptcy.

The stockholders may by mutual consent dissolve a corporation. The statute usually provides a way in which this may be done. Non-user for a long time may under statutes amount to forfeiture of a charter. Non-user of some power, however long continued, does not deprive a corporation of such power.

Sec. 129. RESULTS OF DISSOLUTION. Upon dissolution the assets of a corporation are to be applied to the payment of its debts, the balance to be distributed among the stockholders.

When a corporation is dissolved, its assets go to the payment of its debts. What assets have been given as security are of course applicable only to that purpose so long as the secured debt is unpaid. Creditors with liens are to be satisfied in the order of the priority of their liens. General creditors share *pro rata* after the better classes of debts are paid.

After debts are paid, the balance of the assets are distributed among the shareholders. If there are shareholders holding shares which are preferential as to assets, they are to be first satisfied. But preferred shareholders come in ahead of common stockholders only, not ahead of creditors.

APPENDIX A.

FORMS.

APPENDIX A.

FORMS.

1. The statement of a proposal to form a stock corporation under Illinois laws.

State of Illinois, }
..... County. } ss.

To James A. Rose, Secretary of State:

We, the undersigned, ...
.....
.....
.....

propose to form a corporation under an act of the General Assembly of the State of Illinois entitled "An Act Concerning Corporations," approved April 18, 1872, and all acts amendatory thereof: and that for the purposes of such organization we hereby state as follows, to-wit:

1. The name of such corporation is .....
.....

2. The object for which it is formed is .....
.....
.....
.....
.....
.....

3. The capital stock shall be .....
4. The amount of each share is .....
5. The number of shares .....

6. The location of the principal office is in .... in the County of ..... State of Illinois.

7. The duration of the Corporation shall be .... years.

.....

.....

(Note.—This must be acknowledged and sworn to before a notary public and a form for that purpose is printed on the back thereof. The parties signing this statement are called "Commissioners." There must be at least three and not more than seven, in Illinois.)

2. Illustrative object provisions in charter.

(1) To own and conduct a restaurant.

"The object of this corporation shall be to own, operate and conduct restaurants, lunch rooms, cafeterias and eating houses and places of refreshment. To own and operate bakeries and kitchens for the preparation of bakery goods and foodstuffs of every sort for use in its own restaurants, lunch rooms and other places and for sale at wholesale or retail to others or upon hire for others. To carry on a general catering business, and in general to do all and every thing that may properly appertain to the business of conducting restaurants and lunch rooms of all classes and descriptions and the business of preparing food for consumption at wholesale or retail, and a general catering business."

(2) To own and operate a laundry.

"The object of this corporation shall be to own, operate and conduct the business of a laundry for the washing, cleaning, ironing, pressing, renovating of wearing apparel, household linen and clothes of every kind and description; to dye and dry clean all sorts of fabrics; and to buy, sell and deal in all kinds of machinery necessary or useful in the laundry, cleaning and dyeing business."

3. Form of by-laws.

(Note: These by-laws are intended to be merely suggestive; in any case the by-laws adopted should be framed according to the actual needs and circumstances of the particular corporation.)

ARTICLE I.

STOCK.

Sec. 1. Certificates of stock shall be in such form as the President shall decide. All certificates must be signed by the President and the corporate seal shall be affixed and attested by the Secretary.

Sec. 2. Shares of capital stock may be transferred by endorsement on the certificate in the usual form and the surrender of such certificate to the Secretary for cancellation, who shall take up and cancel the same attaching it to the original stub and who shall thereupon issue a new certificate to the transferee.

Sec. 3. The stock books of the company shall be closed to transfers forty-eight hours before the annual meeting.

ARTICLE II.

STOCKHOLDERS.

Sec. 1. The annual meeting shall be held on the first Friday after the first Monday of January of each year at the hour of 3 o'clock P. M., at the general offices of the company, for the election of directors or the transaction of such other business as may come before the meeting.

Sec. 2. Special meetings may be held at any time upon call by the President whenever he shall deem a special meeting advisable or whenever he is so directed by a res-

olution of the Board of Directors, or whenever the stockholders representing one-third of the capital stock shall request him in writing so to do, specifying in such writing the time and object. Such meeting shall be held at the same place and at the same hour of the day as is provided for holding the annual meeting.

Sec. 3. The Secretary shall mail to every registered stockholder at his known place of residence a written or printed notice of the time and place of holding every annual or special meeting, and in case of special meetings shall state the object of the meeting. Such notice must be mailed at least five days prior to the time of holding the meeting. Provided that stockholders may come together in special meeting at any time without notice provided all stock is represented in person or by proxy, and notice may in every case be waived.

Sec. 4. A majority of the stock must be present at any meeting to constitute a quorum. But a smaller number may adjourn the meeting to some other time without further notice.

Sec. 5. No business shall be transacted at any special meeting or any adjournment thereof except such as shall be mentioned in the notice; unless all stock is present or represented and other business is introduced by unanimous consent.

Sec. 6. The President and Secretary of this corporation shall act as President and Secretary of the meeting, unless the meeting shall elect a Chairman and Secretary pro tem to act in their stead.

Sec. 7. The stockholders shall elect at every annual stockholders' meeting from among their number a board of five directors to serve for one year or until their successors are elected and duly qualified.

Sec. 8. Voting for directors shall be by ballot, and all other votes shall be by ballot when the majority of those present so demand.

Sec. 9 The order of business at the annual meeting shall be as follows:

1. Reading and disposal of minutes of last meeting and all other undisposed of minutes.
2. Annual Reports.
3. Reports of Committees.
4. Unfinished Business.
5. New Business.

ARTICLE III.

DIRECTORS.

Sec. 1. The affairs of this corporation shall be managed by a Board of Directors who shall be elected by the stockholders at their regular annual meeting and who shall hold office for one year or until their successors are elected and qualified. Any vacancy occurring in the board may be filled by the other members thereof for the unexpired period.

Sec. 2. No person shall be eligible to the office of director who is not a stockholder. A transfer by a director of all his stock shall operate as a resignation by him.

Sec. 3. No director shall receive any salary or compensation for his services as director.

Sec. 4. The directors shall meet in regular session once a year immediately after the annual stockholders' meeting and at the same place and also shall meet once every month on the third Monday thereof at 3 o'clock P. M., at the general office of the company. A reminder of these monthly meetings shall be mailed by the Secretary twenty-four hours before the time of the meeting.

Sec. 5. Special meetings may be called at any time by the President or any three directors. The other directors

shall be entitled to three days' notice of such meetings, but the directors may meet in special session at any time without notice if all attend or waive notice.

Sec. 6. A quorum shall consist in a majority of the directors.

ARTICLE IV.

OFFICERS.

Sec. 1. The officers of this corporation shall consist in a President, a Vice President, a Treasurer and a Secretary. They shall be elected by the directors at their annual meeting and hold office for one year or until their successors are elected and qualified.

Sec. 2. No officer except the Secretary shall be other than a stockholder. A sale of all his stock by any such officer shall operate as a resignation by him of his office.

Sec. 3. All officers may be required by the directors to give bonds in such sums and with such sureties as the Directors shall determine. Such bonds shall be conditioned for the faithful performance of the duties of their office.

Sec. 4. The directors may at any time demand the resignation of any officer, and upon refusal, may dismiss said officer and elect his successor.

Sec. 5. The President shall have general charge of the affairs of the company. He shall have supervision over and direction of all officers and employees of the company, and shall see that their duties are properly performed. He shall sign all bonds, obligations or other contracts in the name of the company. He shall preside at the meetings of the Board of Directors. He shall present a report of the year's business to the directors just before the annual stockholders' meeting and the same shall be read at such annual meeting.

The President shall have power from time to time to employ clerks and agents and fix their salaries. But this power shall be at all times under the immediate control of the Board of Directors.

Sec. 6. The Vice President shall preside at the meetings of the Board of Directors in the absence or disability of the President and shall perform such other duties as the directors may by resolution prescribe.

Sec. 7. The Treasurer shall receive and disburse all funds of the company. He shall keep the funds in some Chicago Bank and shall deposit all money received in the bank account of this company to its credit. The Treasurer of the company shall sign all checks drawn on the bank account of this company. He shall file and preserve all vouchers. He shall render an account at the annual meeting and at such other times as the directors may by resolution require.

Sec. 8. The Secretary shall attend all regular and special meetings of the directors and stockholders and shall keep in a book prepared for that purpose a true record of all proceedings, and shall have charge of the books, documents and papers of the company. He shall have charge of the seal and attach it to all documents requiring sealing, but in his absence or refusal to act the President may attach such seal. The Secretary shall serve all notices required. He shall keep a calendar of things required to be done by the corporation or by him at certain dates and faithfully observe said calendar. And in general he shall do all such things as appertain to the office of Secretary and as shall be from time imposed upon him by the Board of Directors.

ARTICLE V.

MISCELLANEOUS.

1. The fiscal year of this company shall begin January 1st and end December 31st of each year.

2. These by-laws may be altered, amended or repealed at any regular meeting of the Board of Directors by a vote of the majority of the same, or at any special meeting of the directors when all are present.

4. Subscription contract.

We, the undersigned, hereby severally subscribe for the number of shares set opposite our respective names, to the Capital Stock of General Laundry Company, and we severally agree to pay the said company, for each share, the sum of One Hundred Dollars. Chicago, Illinois, Nov. 15, 1911.

Name	Address	Shares	Amount

5. Certificate of stock.

No. .... Shares

Incorporated Under the Laws of the State of

ILLINOIS

GENERAL LAUNDRY COMPANY.

Capital Stock $10,000 Shares, $100 each

Chicago, Illinois.

This is to Certify, that ..... is the owner of ..... Shares of the Capital Stock of

GENERAL LAUNDRY COMPANY.

Fully paid and non-assessable.

transferable only on the Books of the Company, in person or by Attorney, on the surrender of this Certificate properly endorsed.

In Witness Whereof, the Seal of the Company and the signatures of the President and Secretary are hereto affixed at ..... this ..... day of ..... A. D., 19..

.....
President.

.....
Secretary.

6. Power of attorney on the back of certificate.

For Value Received, the undersigned hereby assign.. and transfer.. unto ....., ... Shares of the Capital Stock within mentioned, and do.. hereby constitute and appoint ..... to be ..... true and Lawful Attorney, irrevocable for and in ..... name and behalf to make the necessary transfer on the books of the company.

Witness ..... hand at ..... this the ..... day of ..... A. D. 19..

Witness:

.....

.....

7. Stub from which certificate is detached.

CERTIFICATE.

No. .....

For ..... Shares

Issued to

.....

.....

Dated ..... A. D. 19..

Transferred from

.....

Dated ..... 19..

No. Original Certificate.	No. Original Shares.	No. of Shares Transferred.
.....	.....	.....
.....	.....	.....
.....	.....	.....
.....	.....	.....
.....	.....	.....

Received this Certificate

.....

8. Notice of annual meeting.

25 N. Blank Street,
Chicago, Illinois,
Dec. 24, 1911.

To the Stockholders of General Manufacturing Co.

The annual meeting of the stockholders of the General Manufacturing Co. will be held at the general offices of the company at 25 North Blank Street, Chicago, Illinois, on the 10th day of January, 1912 at 3 o'clock P. M. for the purpose of electing directors for the ensuing year and transacting such other business as may come before the meeting.

Enclosed find a proxy which you may sign and return. In the event that you are present in person you may withdraw the same.

.....
Secretary.

9. Proxy for annual meeting of stockholders.

KNOW ALL MEN BY THESE PRESENTS, That the undersigned stockholder of the General Manufacturing Company, hereby constitutes and appoints, James Monroe

and Harry Smith, or either of them, the attorney and proxy of the undersigned, to attend and represent the undersigned at the Annual Meeting of the stockholders of the General Manufacturing Company to be held on the 10th day of January, A. D. 1912, and all adjournments thereof, and for and on behalf of the undersigned, to vote according to the number of shares of the stock of said company, which the undersigned would be entitled to vote if there personally present, hereby ratifying and confirming all that said attorneys and proxies, or either of them, shall do in the premises, giving and granting unto said attorneys and proxies full power of substitution and revocation.

Dated at Chicago, Illinois, January 5, 1911.

..... (Seal.)

In presence of

.....

.....

10. Minutes of an annual meeting of stockholders.

MINUTES OF THE ANNUAL MEETING OF THE STOCKHOLDERS OF THE GENERAL MANUFACTURING COMPANY.

The annual meeting of the stockholders of the General Manufacturing Company was held at the office of the company at No. 25 North Blank Street in Chicago, Illinois, on the 10th day of January, 1912, at 3 o'clock P. M.

The meeting was called to order by the President of the corporation who was unanimously chosen Chairman of the meeting, and who served as such throughout the meeting. Mr. James Brown, the Secretary of the company being present, was appointed and acted as Secretary of the meeting.

There were present the following stockholders in person who responded to the roll call.

(Here follow names of stockholders, with number of shares set opposite their respective names.)

The following stockholders were present by proxy:

(Here follow the names of the stockholders, with the names of their proxies and number of shares set opposite their respective names.)

There being a quorum of the stock present the company proceeded to the transaction of business.

The proxies presented were ordered filed for record with the Secretary.

The Secretary presented, read and appended in a convenient place for perusal the roll of all stockholders entitled to vote, and it remained so disclosed throughout the entire meeting.

The Secretary then presented and read a copy of the notice of the meeting together with the proof of mailing the same to each registered stockholder at his address as it appears on the books of the company at least ten days prior to the date of holding the same.

The Minutes of the last annual meeting of the stockholders, held on Jan. 10, 1911, were read and approved.

Upon motion duly made and seconded, the meeting proceeded to the election of 5 directors by ballot according to the by-laws and the polls were opened at 3:20 o'clock P. M.

On motion duly made and seconded Messrs. Henry Smith and Walter Goodwin were appointed inspectors of election and the stockholders delivered to them their votes.

The annual report of the President was then presented and read and upon motion of Charles P. Johnson, duly seconded, it was

Resolved: That said report be received and adopted and ordered filed with the Secretary.

(Here insert other business, including communications received, unfinished and new business.)

The polls, having remained open thirty minutes and every stockholder having voted, were closed and the inspectors presented their report in writing showing that the following gentlemen, all stockholders, had received the highest number of votes:

(Here place names.)

The Chairman thereupon declared the said gentlemen duly elected directors of the company to hold office for one year and until their successors are elected and qualified.

The Secretary was directed to insert in the minute book a copy of the following papers:

1. Notice of meeting and proof of mailing thereof.
2. Form of proxy.
3. President's report.

There being no further business, the meeting adjourned.

.....
Secretary.

11. Form of minutes of directors' first meeting.

Minutes of the meeting of the Board of Directors of General Manufacturing Company, held in Chicago, Illinois, at 25 North Blank Street, January 10, 1911, at the hour of 4 o'clock P. M. by the unanimous consent and appointment of all of the Directors of said corporation.

The meeting was called to order by Charles Henderson, who was elected temporary chairman.

Henry Anderson was elected as temporary Secretary.

The following directors were present in person:

James Smith,
Harold Wright,
Henry Anderson,
Abel Jones,
Axel Johnson,

being all of the directors of said corporation. On motion duly made and seconded it was

Resolved, That the meeting go into the election of permanent officers.

(Note: If this meeting was in a state in which the directors make the by-laws, those could be adopted at this point, or a committee could be appointed to prepare them. If the by-laws were not adopted at this meeting, the directors by resolution could establish the permanent offices or could simply proceed to the election of the usual officers, and make the by-laws, subsequently adopted, conform to this state of facts.)

On motion duly made and seconded, Harold Wright was elected to the office of President of the company, for the term of one year and until his successor is chosen and qualified; and being present in person, Mr. Wright signified his acceptance of said office, and thereupon took the chair and presided during the remainder of the meeting.

(Here elect other officers. If more than one candidate for an office, the election may be by ballot.)

Thereupon the following communication was read to the Board of Directors by the President.

To the President and Board of Directors of the General Manufacturing Company:

Gentlemen:

I am the sole owner of the following described property located at Number 302 Dearborn Street, Chicago, Illinois, viz.:

A manufacturing plant consisting in, etc., valued at	$10,425.00
Merchandise, valued at	1,874.00
Accounts receivable	1,247.00
Cash on hand	672.00
Total	$14,218.00

This property is owned in connection with a business which has been conducted by me in my name for ten years. I regard the good will thereof to be worth at a fair conservative value, at least $7,500.

I propose to sell said property and good will to your company, provided you will assume the outstanding accounts, amounting to $3,718.00, and the outstanding bills payable amounting to $1,000, for the price of Seventeen Thousand Dollars and I will receive in payment of said purchase price of said property One Hundred and Seventy shares of the capital stock of your company, being the number of shares I have heretofore subscribed for in my original subscription, the said One Hundred and

Seventy shares to be issued to me as fully paid and non-assessable, the certificates to be issued and delivered to me as soon as I have delivered and conveyed and assigned said property to your company.

Respectfully,
JAMES SMITH.

Dated, Chicago, Illinois, November 20, 1911.

Mr. James Smith then retired from the room and remained out during the following discussion and Resolution. After some discussion, the following Resolution was adopted, all directors except Mr. James Smith voting in its favor.

Whereas: James Smith has offered by the written proposition above spread upon the minutes, to sell, assign and convey to this corporation certain property for $17,000 and

Whereas: Said property is deemed by the Board of Directors to be worth the sum of $17,000 to this corporation, and it is deemed to the best interests of this corporation to accept said proposition, Therefore, it is

Resolved, That this company accepts the above proposition of Mr. James Smith, and hereby purchases said property mentioned in said proposition and assumes the outstanding accounts and bills payable as therein stated, and shall pay said Seventeen Thousand Dollars for said property by issuing and delivering to said James Smith One Hundred and Seventy shares of this company of the par value of $100, as fully paid and non-assessable, being the original subscription of said James Smith, upon the execution of the proper instruments of transfer and bills of sale.

Be it Further Resolved, That the Secretary be and he is hereby authorized to accept said property on behalf of this company and deliver certificates for one Hundred Seventy shares, as aforesaid.

There being no further business, the meeting adjourned to convene again at 2 o'clock P. M. on Jan. 12, 1911, at the same place.

(Note: In the minutes of the stockholders held prior to the above meeting, it should appear that they received the above communication [which need not be set out at length in such minutes] and that they referred it to the directors and advised its acceptance.)

(Note: In a subsequent meeting the bill of sale and other instruments of transfer, if any, executed and received pursuant to the resolution above, should be copied in the minutes and approved.)

12. Certificate of copy of resolution for bank upon filing account.

"*Resolved*, That the Treasurer be hereby authorized to open a bank account in the name and on behalf of this company with the 16th National Bank of Chicago, Illinois, and that he deposit the funds of this company therein; and that the checks of this company against such deposit be signed by its Treasurer and countersigned by its President, and said 16th National Bank of Chicago is hereby authorized to honor said checks and make the payments according to the tenor thereof, until notice to the contrary."

I, William Smith, Secretary of the General Manufacturing Company do hereby certify that the above and foregoing is a true, complete and correct copy of a resolution of the Board of Directors of said company, passed at a duly convened meeting thereof, held on the 27th day of November, 1911, as taken from and compared with the original resolution in the minute book of said company.

In Witness Whereof, I have hereunto affixed my signature and the seal of the company at Chicago, this 28th day of November, 1911.

(Corporate Seal) WILLIAM SMITH,
Secretary.

13. Resolution declaring dividend.

Resolved, That a dividend of five per cent on the capital stock of this corporation be and the same is hereby de-

clared out of the surplus earnings of the corporation, payable to the stockholders of the corporation as they appear of record on the books of the company at the close of business on the 24th day of December, 1911, said dividend to be due and payable December 31, 1911.

or

Resolved, That a dividend of five per cent. on the capital stock of this corporation be and the same is hereby declared out of the surplus earnings of the corporation, payable to the stockholders in proportion to their respective holdings and payable on January 31, 1911.

14. Notice of special meeting (to increase stock).

25 N. Blank Street, Chicago, Ill., Nov. 20, 1911.

To James Smith.

You are hereby notified that a special meeting of the stockholders of the General Manufacturing Company, will be held at its general offices at 25 North Blank Street, Chicago, Illinois, on the 20th day of December, 1911, at 2 o'clock P. M. for the purpose of considering the question of increasing the capital stock of said corporation, at which time you are requested to appear.

.....
.....
.....
Directors.

15. Form of resignation for officer.

November 20, 1911.

To the President and Board of Directors of the General Manufacturing Company,

Gentlemen: I herewith tender my resignation as a Treasurer of the General Manufacturing Company to take effect immediately.

ANDREW JOHNSON.

APPENDIX B.

QUESTIONS AND PROBLEMS.

APPENDIX B.

QUESTIONS AND PROBLEMS.

CHAPTER ONE.

1. Why is a corporation called an "artificial person?"

2. A law is passed making it a misdemeanor for any "person" to employ a child under 14 years of age. Does this apply to corporations? Why?

3. The stock of a certain railroad company was held by a manufacturing corporation which had no power of eminent domain. The railroad company brought proceedings to condemn certain property for railroad uses. A defense was made that this was really an action by the manufacturing company which owned all the stock. Should this defense prevail? Why?

4. State some differences between a corporation and a partnership. What is a "joint-stock" company?

5. State some reasons for the incorporation of companies. Explain fully.

6. What is a stock corporation? A non-stock corporation? A municipal corporation? A quasi-municipal corporation?

7. Can a corporation commit a tort? Can it commit a crime? What in general is its power to contract?

CHAPTER TWO.

8. Can a corporation exist without a charter?

9. What is the power of the United States government to incorporate companies?

10. State in a general way how incorporation of a company is brought about under present state laws.

11. In what does the charter of a corporation consist?

12. What was the decision in the Dartmouth College case? How was its effect in a large measure overcome in respect to corporations thereafter created in the various states?

13. Define a de facto corporation; a de jure corporation. May there be a de facto corporation without a charter? What three things are essential to existence as a de facto corporation?

14. May a charter be amended? In what way? Is it as easy to amend a charter as a by-law? If a charter is amended to increase the capital stock, how much of the capital stock is each shareholder entitled to?

CHAPTER THREE.

15. State some reasons why it is sometimes a disadvantage to incorporate?

16. Why is it better, other things being equal, to incorporate in the home state?

17. What limitations are there upon the choice of a corporate name? Need the name in itself signify that the concern is incorporated?

18. What are the by-laws? Name some usual provisions? Do the stockholders or the directors make the by-laws? Are by-laws absolutely essential? How does a by-law differ from a resolution?

19. What is the minute book? The stock ledger? The transfer books? The stock certificate book?

CHAPTER FOUR.

20. Is a promoter an essential character in the formation of a corporation? What uses has the promoter? When is the corporation liable upon the contracts of the promoter?

21. A had an option to purchase certain land for $67,500. He represented to certain parties that the land could not be bought for less than $80,000. A corporation was then formed by A. and the others, and the land was then conveyed to the corporation for $80,000, thereby giving A. a secret profit of $12,500. The corporation now sues A. for that amount. Can it recover? Why?

CHAPTER FIVE.

22. Define capital stock; share of stock. What fixes the amount of capital stock?

23. What is common stock? Preferred stock? Unissued stock? Treasury stock?

24. Can a preferred shareholder sue the corporation if a dividend is not declared?

25. What is the purpose of the stock certificate?

CHAPTER SIX.

26. A, being sued upon his subscription to shares of a corporation, defended that he had been induced to subscribe for such stock by fraudulent representations made by such corporation through its agent. (a) In order that he may prevail what must he show in respect to the *character* of such representations? (b) What must he show in respect to his diligence in repudiating the subscription? (c) Suppose the corporation becomes insolvent before he repudiates, why would this have any bearing upon his rights?

27. In order to induce B., C., D., and E., to subscribe to the shares of a certain corporation, A. was induced to subscribe on condition that he should not be required to pay more than 50 per cent of the par value of the shares. This collateral agreement was unknown to others. A. is now sued by the corporation. Can he set up this agreement?

CHAPTER SEVEN.

28. May a corporation issue shares in exchange for property other than money?

29. What is "watered stock"?

30. A., B. and C. form a corporation capitalized at $100,000, A. is an inventor and has a patent which he expects to become very valuable, but as yet it has no value in the market. A. is to receive stock whose par value is worth $99,800 in exchange for his patent; and certificates are issued to him reciting that his stock is fully paid and non-assessable. B. and C. subscribe for one share each of the par value of $100. The corporation soon becomes insolvent owing $10,000. Have the creditors any remedy against A?

31. A. subscribes for stock at 10 per cent of its par value, receiving certificates reciting that the stock is fully paid and non-assessable. Can the corporation recover anything further? Can creditors?

32. May a corporation declare a forfeiture of stock for non-payment?

CHAPTER EIGHT.

33. If the directors refuse to declare dividends, what remedy has the stockholder?

34. The directors of the A. B. Company, a corporation, are planning to make a contract which the corporation has no charter power to enter into. This contract will involve the expenditure of considerable money. One of the small stockholders desires to prevent this action. Has he any remedy? Discuss fully his rights.

35. Can a single stockholder prevent a sale of all the assets of a solvent, going concern, made for the purpose of discontinuing the business of the company? Can he prevent an amendment of the charter which will result in a material change of object?

36. State the right of a stockholder to inspect the books and records of the company.

37. Discuss fully the right of a stockholder to enter into contracts with the company, as for instance, contracts to sell to, or buy from it or contracts of employment.

CHAPTER NINE.

38. State some purposes of a stockholders' meeting. In general, what two classes of stockholders' meetings are there?

39. Where a special meeting is called, what must the call and the notice contain? Is it necessary to give a notice of the annual meeting?

40. In what two ways may a stockholder have himself credited with attendance and exercise his right to vote?

41. May a proxy be recalled by the stockholder?

42. What is a voting trust? What is its purpose?

43. What is meant by "closing books" for a stockholders' meeting? What right has a corporation thus to close its subscription books?

44. What constitutes a quorum at a stockholders' meeting?

45. There are three stockholders, A., B. and C. in the M. Manufacturing Company. A. owns 100 shares, B., 50 shares, C. 1 share, and there are 25 shares treasury stock and 24 shares unissued stock making a total of 200 shares being all the shares of stock of said corporation. A., B. and C. attend a stockholders' meeting. How many votes can A., B., C. and the corporation cast respectively?

46. What is meant by cumulative voting? Illustrate.

47. What officers preside at and conduct the stockholders' meeting?

CHAPTER TEN.

48. What is a stock certificate?

49. How is transfer of shares effected?

50. A. borrowed from B., a broker, $1,000, and to secure B., left with him a certificate of 20 shares of stock in the M. Com-

pany, worth $2,000. There was the usual blank on the back of the certificate, which A. signed in order that B. might be able to enforce his security in case of A's default. Long before the loan was due, B., in violation of his contract, representing that he was the owner filled up the blank over A's signature and sold the certificate to C., who paid B. $2,000. C. surrendered the certificate to the transfer clerk of the M. Company, secured a new certificate in the place thereof and was registered on the books as a stockholder. What are A's rights, if any, against B., C., and the M. corporation? Does C. get a good title to the stock? Suppose B. had forged A's signature. Would this make any difference?

51. A. had a share of stock in the M. corporation which recited that the stock was fully paid and non-assessable. He transferred it to E., a purchaser for value. As a matter of fact the stock was totally unpaid. The corporation became insolvent. Have the creditors of the corporation any rights against A.? Against B.?

52. May by-laws be passed prohibiting transfer of stock?

CHAPTER ELEVEN.

53. State the various kinds of dividends.

54. Who declares dividends?

55. As between one who owns stock when a dividend is declared and one who owns it at the date the dividend is by its terms payable, who is entitled to the dividend?

56. State the right to dividends upon preferred stock.

CHAPTER TWELVE.

57. What is the purpose of the directorate?

58. Must a director be a stockholder? Must he be a resident of the state?

59. How are directors elected?

60. May a director be removed before the expiration of the term for which he was elected?

61. May a director make a contract with the corporation? Suppose that his vote is necessary to secure the contract, yet the contract is fair, may a stockholder object?

62. In what manner must directors exercise their powers?

63. What constitutes a quorum at directors' meetings? Suppose that a bare quorum is present, and a majority of that quorum is a minority of the full number of directors, can such majority pass resolutions?

CHAPTER THIRTEEN.

64. State the usual duties of the President; the Vice-President. What are their usual powers to act for and bind the corporation?

65. State the usual duties of the Secretary; his authority to bind the corporation upon contracts.

66. State the usual duties of the Treasurer; his authority to bind the corporation upon contracts.

67. If a contract of the corporation is to be signed by the President, and the seal affixed and attested by the Secretary, illustrate the manner of signature and sealing that should be employed by such officers.

CHAPTER FOURTEEN.

68. Has a corporation the power to issue bonds and to mortgage its property where that is not expressly given in the charter?

69. State the two usual forms of bonds.

70. How is the bond secured?

CHAPTER FIFTEEN.

71. What is the "trust fund" doctrine? If the corporation becomes insolvent, what rights have creditors against stockholders whose stock is unpaid. Are stockholders entitled to share in the division of the assets before creditors are completely

paid? Suppose there are preferred shareholders who hold their shares under an agreement with the corporation that they are entitled to priority in a division of the assets of the corporation, as well as a priority in the payment of dividends, does this give them the right to be paid before the general creditors?

CHAPTERS SIXTEEN AND SEVENTEEN.

72. What are the three classes of powers of a corporation? What are the powers inherent in corporate existence?

73. What powers will be implied from the express charter powers? State the rule.

74. A railroad company guaranteed the interest and dividends on stock and bonds of a summer hotel, which would increase its business. Do you think this an ultra vires act? Discuss. (Western Maryland R. Co. v. Blue Ridge Hotel Co., 102 Md. 307, 2 L. R. A. N. S. 887).

75. What is the power of a corporation to own real estate where there is no such power expressly given in the charter.

76. May a corporation own shares of other corporations, where it has no such powers expressly given? May a corporation acquire its own shares?

77. Where a contract has been made which is ultra vires, may it ever be enforced? When may it not be enforced?

CHAPTER EIGHTEEN.

78. Define a foreign corporation.

79. Name some common statutory provisions in respect to foreign corporations.

80. Suppose that all the stockholders, directors, and officers of a corporation live in Illinois, but it is incorporated under the laws of New Jersey, is it a foreign corporation in Illinois?

81. When does a foreign corporation have a right to enter a state without complying with the foreign corporation law?

CHAPTER NINETEEN.

82. Define a "trust." Is it legal or illegal?

83. What is the attitude of the law toward corporations which are formed to monopolize or restrain trade?

CHAPTER TWENTY.

84. Name the various ways in which a corporation may be dissolved.

85. Upon dissolution what becomes of the assets of a corporation?

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